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ABSTRACT

A study explored the potential economic impacts of a large and successful national program of consumer education. Following a literature review, a qualitative analysis was performed on a wide range of topics. The topics pertained to information and the process of consumer choice, the role of advertising, consumer sovereignty and the supply system, and the potential benefits of consumer education. It was concluded that (1) the basic role of consumer education should be to contribute to establishing consumer sovereignty in the marketplace so that the economy can more nearly achieve its legitimate purpose of maximizing the material well-being of the people as a whole, (2) the long-term benefits from consumer action to intelligently influence supply will probably be greater than the benefits from better informed choice by passive consumers, and (3) in general, the prime focus of consumer education should be to facilitate the involvement of citizens in determining the conditions of economic choice confronting them. (EM)

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POTENTIAL ECONOMIC BENEFITS OF CONSUMER EDUCATION

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PREFACE

The Public Interest Economics Center (PIE-C), a non-profit corporation in Washington, D.C., performs scholarly research in economic policy and tries to affect decisions at all levels of government which will bring about improvements in social welfare.

PIE-C undertook to explore the potential economic impacts of a large and successful national program of consumer education. This report on its efforts (which is presented in partial fulfillment of a U.S. Office of Education Purchase Order No. P007600421) is the result.

The project was the product of a team effort by Steve Buchanan, Marc Breslow, and Allen R. Ferguson. The bulk of the literature review is the work of Marc Breslow. The analysis and writing were primarily by Steve Buchanan and Marc Breslow, with advice and criticism from Dr. Ferguson. Barbara Schuyler edited and typed the manuscript, with assistance from Ebony Dixon and Richard Reid.

Throughout the duration of the project, PIE-C had the cooperation of Dr. Dustin W. Wilson, Jr., Director, and Dr. Mary Beth Minden of the Office of Consumers' Education, Office of Education.

The main findings of the project are recapitulated in the summary and suggest that orientation of consumer education toward an understanding of the nature of the market system, the role in the system played by the government and consumers, and the nature and purpose of the information provided to consumers could yield very substantial economic dividends.

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OVERVIEW

This report surveys and assesses in a very qualitative way the potential benefits which could result from consumer education activities of the federal government. In carrying out our task we found that assessing benefits presupposes that the goals of consumer education be suitably defined. In fact, it was the clarification of the purposes of consumer education which received the major share of our attention and effort. Our findings indicate some areas which should have particularly beneficial long term effects on consumers' welfare.

Unfortunately, it is questionable whether many of the consumer education activities that could have significant effects would be politically feasible. For example, a direct attack on advertising or on the impregnation of entertainment content of television programs with inferential messages might be beyond the pale.

In general we conclude that the prime focus of governmentally sponsored consumer education programs should be to facilitate the involvement of citizens in determining the conditions of economic choice confronting them. The initial step in such an undertaking is to make citizens aware of the pervasiveness and significance of governmental and, hence, citizen responsibility in determining the entire range of (market) opportunities which the individual encounters, both as consumer and worker. Such awareness must also include the economic and political influence of commercial interests, with emphasis on what motivates these interests to present incomplete and biased information, and with emphasis also on the differences between factual and persuasive information.

In our view consumer education is a part of the information system within which individuals make three separate but interrelated economic choices: the choice as to which goods to buy, the choice as to how much of available income and credit to spend and how much to save, and the choice as to how much time to spend in earning income in order to increase present or future consumption as against time spent in non-market pursuits, such as leisure and self-fulfillment.

Consumers are subjected to a multiplicity of influences affecting their decisions in these areas: their individual experiences, informal communications with associates, and institutionalized information flows, such as advertising, entertainment, propaganda, and education. Thus, consumer education sits in a matrix of other sources of information. It can produce the greatest benefits, if it fills gaps in the complementary sets of information available to consumers and offsets information that is contrary to the interest of consumers. Some

initial step in this direction would seem to be both legitimate and feasible. How much further the government can go in facilitating citizen economic determinacy is open to question. The potential benefits of the kind of consumer education just described is a redirection of present programs which are dominated by the experience of those associated with the more traditional role of consumer education, which has been concerned with improving the individual's ability to select among existing market choices.

The point of departure for this study is the conventional one in welfare economic analysis: that the market choice of perfectly well-informed rational individuals will in an ideal competitive economy maximize the economic welfare of the society, for any given distribution of wealth. Our conclusions were developed by examining first how the actual circumstances of the consumer and the producer systematically differ from this analytically useful but unrealistic norm.

It may be important to emphasize, for readers unfamiliar with formal economic thinking, that from the viewpoint of economists the only legitimate purpose of economic activity is to maximize the well-being of the members of the society, i.e., of the people in their roles as consumers and workers. To the extent that the economic system fails to produce the kinds and amounts of goods and services that consumers independently prefer, and to the extent that it imposes more onerous work on them than is necessary or is fully compensated for, the economy is operating inefficiently. (This concept of the purpose of economic activity obviously differs greatly from the actual aims of some, if not all, the owners of major blocs of economic resources and power.) Second, the economy, at least within the present social structure, cannot achieve that goal unless producers compete effectively for customers and for labor and other productive resources, and unless well-informed individuals make unfettered decisions in the three major areas of choice described above (i.e., the choice of which goods to buy, the choice of how much to spend and to save, and the choice of how much time to spend in earning income as against time spent in non-market pursuits.) In such an economy the entire system tends to be responsive to the needs of consumers, as expressed by their market demands. To the extent that consumers lack the information needed to make well-informed choices and to the extent that the market is structured that sellers do not have to compete for the consumer's dollar, the system fails to provide as much well-being as it could, given the resources available and given the distribution of wealth.

We see the role of consumer education as moving the society closer to the situation in which the economy will be fully responsive to consumer preferences. Even so, with ample information, freedom of choice, and competitive markets, the welfare of consumers will be impaired by the inequitable distribution of income and wealth. This is perhaps the most important current economic problem, and although, ideally, a properly developed national program of consumer economics could advance general welfare substantially, we were forced by limitations of time and resources to exclude that consideration from our analysis.

There are a number of consumer education areas where research beyond that reported in this paper holds promise for major social pay-off; e.g., the consequences of economic concentration on consumer choice and welfare; the nature of the trade-offs among work and income, leisure, saving, and consumption; the role of governmental regulation in affecting the range of consumer choice; and the role of governmental action in offsetting inadequacies of information available to consumers.

The topics addressed in the course of this study are wide-ranging, and many of the relevant issues are elusive because it is impossible to quantify them in all their dimensions. Thus we have made extensive use of examples to illustrate and substantiate our arguments and assertions. Though this methodology is open to obvious criticisms, we believe we have made a compelling case that the potential benefits of an appropriately conducted program of consumer education are very large indeed, particularly if cumulative in the long term. Consumer education programs should be expanded to facilitate citizens' efforts to increase their own economic self-determinacy. This can be done by making individuals more aware of the choices they make regarding consumption, work, and leisure, and of the potential benefits of taking part in the process which ultimately determines the conditions of choice.

SUMMARY AND CONCLUSIONS

SUMMARY

Consumer education is a part of the information system within which individuals make three separate but interrelated economic choices:

- the choice as to which goods to buy
- the choice as to how much to spend and how much to save, and
- the choice as to how much time to spend in earning income rather than in non-market pursuits, such as leisure and self-fulfillment.

Consumer education sits in a matrix of other sources of information. It can, in our Judgment, produce the greatest benefits if it fills gaps in the useful information available to consumers and offsets information that is contrary to the interest of consumers.

The potential economic benefits of an effective program of consumer education consist primarily of eliminating the social costs of economic problems that beset consumers.

It can be readily demonstrated that a market economy cannot work to the benefit of the people as a whole unless consumers are well-informed and their preferences are free of biased influence by producers. Nor can a market economy perform well, according to that standard, if wealth is not optimally distributed and if goods and services are produced in markets where there is substantial monopoly power.

Deficiencies in Information:

Product differentiation, as manifested in advertising and superficial product characteristics, plays a prime role in the process of consumer choice. Advertising by manufacturers is the major source of information on consumer products, yet its primary intent is to benefit the producer, not the consumer. As a result, the information provided deviates greatly from that which would promote effective consumer decisionmaking.

Although some advertising has social value, much of it is misleading as to the attributes of goods and services and, through persuasive techniques, substantially molds consumer preferences.

These two functions result in a number of serious distortions in the economic and social systems:

- Varying degrees of monopoly power are created in many industries, causing income transfers from consumers to producers and, most importantly, lack of responsiveness of industry to consumer desires.

- Expenditures on uniformative advertising and non-functional physical differentiation of products cause substantial direct waste of resources.
- Consumer preferences are affected in ways that contribute to large-scale distortions throughout the structure of society (in our view the most serious result of the two functions):
  - — Consumption is shifted toward those industries whose products lend themselves best to persuasive marketing.
  - — Savings (and therefore investment and future consumption) suffer relative to current spending.
  - — Allocation of resources toward public goods, including such crucial areas as environmental protection and municipal services, are restricted well below the levels that would be socially desired.
  - — Individuals obtain much less satisfaction than they could from non-market activities, including leisure time and household work.
  - — Workers derive greatly reduced satisfaction from their jobs because of pressure to choose occupations yielding the highest monetary incomes; and finally,
  - — interpersonal differences in consumption levels are viewed in such a competitive manner that one person's gain appears to be everyone else's loss.

In sum, advertising is a prime contributor to a state of society in which it is reasonable to suppose that unlimited increases in national wealth as measured in the marketplace may have little or no positive effect on the overall level of welfare. An effective program of consumer education could have a major benefit in reducing some of these social costs.

Structural Deficiencies:

Monopoly power is a second source of market inadequacy. It can arise from technology forces and from private and public policy.

- In some industries technical conditions of production make it impractical for more than one provider to serve any single market; local distribution of electric power, gas, and water are examples.
- Giant corporations hold a predominant position in the economy, with a large proportion of industry exhibiting high levels of concentration of market power. The growth of conglomerates and of bank influences threatens further erosion of competition and greater centralized decisionmaking.
- In this connection, advertising plays a second role: intense advertising contributes to excess profits, and excess profits cause intense advertising. Thus, misleading information provides to consumers an important source of market structures that tend to diminish consumer welfare.

Possibly even more important than direct price and output effects are the impacts of industrial influence on governmental efforts to protect consumers.

- Federal antitrust policy has been ineffective in limiting or reversing the growth of market power.

- Beyond its failure to control market power, government, under the pressure of special interests, has created monopolistic conditions or protected private market power in many sectors of the economy.
- Similarly, special interests have induced agencies responsible for protection of the health and safety of consumers, the Food and Drug Administration and the Environmental Protection Agency, for example, to pay special attention to the concerns of producers, often at the expense of consumers.

Potential Benefits of Consumer Education:

We see two major areas of potential benefit from a sound and amply funded program of consumer education:

- making consumers better informed about choices, by counteracting the systematic and ubiquitous biases in preference formation advanced by producer interests.
- increasing consumer understanding of the way their marketplace choices are constrained by defects in the supply system, and of how greater consumer influence over the broad range of regulatory, tax, and other public policies could improve their economic and social welfare.

Improving the information base on which consumers made their purchasing decisions and informing them of how they can acquire reliable information for doing so are the traditional areas for consumer education. However, the pervasive influence of special constituencies in providing market information and affecting public policy is as important a determinant of consumers' well-being as are the individual market choices made by consumers. Measures to increase consumer awareness of and participation in the relevant governmental processes could have a profound effect on market conditions and, hence, on consumer well-being. Public education to offset the effects of advertising has considerable appeal. There is no adequate means of estimating the gains to society from doing so.

- It has been roughly calculated that advertising causes a misallocation of resources among market goods of at least two percent of the Gross National Product (GNP).
- The more significant consequences of advertising are the biasing of the economic system toward present consumption over savings; toward market over non-market sources of satisfaction; toward rivalry in personal consumption; and toward consumption activities which have costly results such as health disease and cancer. These consequences are impossible to estimate and quantify, other than to say that the probable effects constitute a substantial degradation of our total societal well being.

- The costs of styling, planned obsolescence, and non-functional physical differentiation of products is no easier to estimate. What is perhaps the best study in this area indicated that the costs of automobile model changes came to more than 25 percent of the purchase price.

The cost of monopolization in the American economy are similarly impossible to estimate, other than to say they are enormous. The record of the government in reversing the trend toward monopoly has been slow and relatively ineffective. Consumers have not had direct access to the process that they might make their interests felt. The economic and social costs have been born by the consumer in both the marketplace and through taxation.

- Reform of the entire governmental role in regulating the conditions of the market could reduce waste of resources equal to perhaps as much as ten percent of the GNP.
- The benefits from increased flexibility of the economy to respond to technological possibilities, social needs, and individual preferences could be equivalent to an additional sizable fraction of GNP.

To state that these potential benefits from consumer education exist is not to say that they can easily be gained. Further, owing to the characteristics of information as a commodity and the limited resources of individuals to obtain and process information so as to choose intelligently, there is no way to avoid such costs completely. It would be overstating the case to reckon all the adverse consequence of misguided choices as true economic costs. However, there are now many and growing consumer advocacy organizations and groups providing consumers with unbiased or rebuttal information concerning conditions of consumer choice.

CONCLUSIONS

The conclusions of the PIE-C study are:

- The basic role of consumer education should be to contribute to establishing consumer sovereignty in the marketplace so that the economy can more nearly achieve its legitimate purpose of maximizing the material well-being of the people as a whole.
- The long-term benefit of consumer action to influence intelligently the conditions of supply would probably be greater than benefit derived from better informed choice by passive consumers.
- In general, the prime focus of consumer education should be to facilitate the involvement of citizens in determining the conditions of economic choice confronting them. The initial step in such a program is to make citizens aware of the pervasiveness and significance of governmental and, hence,

citizen responsibility in determining the entire range of (market) opportunities which the individual encounters, both as consumer and worker. Such awareness must also include the economic and political influence of commercial interests, emphasizing the nature of the incentives which producers have to present incomplete and biased information and the differences between factual and persuasive advertising.

Thus, we view the traditional role of consumer education as facilitating a better informed or a more capable passive consumer choice as being too limited. On the whole, the greatest gap in widely available information seems to lie in the area of citizen action as a method of increasing the range of choice and thus increasing the responsiveness of the entire economic system. The conception of consumer education should be expanded to include the possibility of citizens improving the overall conditions of choice. In this larger concept, the undesirable consequences of private sector advertising and the general shortfall of information on market choices is viewed as a major area for citizen and government initiatives.

Broadly conceived, a sound consumer education program should encompass the following major goals:

- Make the public aware of the conditions of supply in not only consumer but also in the (underlying) producer-goods' markets.
- Make them aware of the role of public (governmental) action in creating those conditions.
- Make them aware of what they can collectively do to improve those conditions.
- Make them aware of the sources and frequently biased content of information currently available about products and incentives to buy.
- Make them aware of sources of valid information and, purposefully, last,
- provide reliable information on goods and services.

A full conception of the role of consumer education must reflect the fact that the choices available to each consumer are constrained by factors which cannot be influenced by individual purchasing decisions. That is, the degree to which the supply system serves consumer interests is limited in ways which can be affected only by group action aimed either directly at the producers of goods and services or toward the conduct of government. As mentional earlier, the general rationale for public involvement in the supply system arises because producer incentives may, for a number of reasons, impair or even systematically undermine the fulfilling of public preferences or needs.

To achieve the goals identified above, one major focus of curriculum development should be an explication of the range of economic problems

besetting the supply of both private and public goods and services. This can be done by:

- Clearly and simply documenting the need for change in many of the economic institutions, particularly at the interface of government and the private sector. This could be structured on a very factual basis.
- Making available more detailed information on the policy alternatives and economics of certain specific issues, such as energy pricing or import/export policies. The average citizen has no readily accessible source of information which will enable him/her to read the newspaper intelligently on these issues. In fact, the same may be said of the average reporter.
- Providing information on how citizens could become more involved in the issues affecting them. This is an additional topic for research; and presenting and disseminating information effectively on vehicles for public involvement should be the major concern.
- Clearly, explication of the nature of the trade-offs among work, leisure, consumption of market vs. non-market goods, and spending, borrowing and saving. It is not necessary to engage in a controversial criticism of advertising, though there is some factual evidence that advertising may be far more persuasive in determining our styles of consumption and spending than is commonly realized.

I. INFORMATION AND THE PROCESS OF CONSUMER CHOICE

A. Introduction

To examine properly the potential benefits of consumer education activities it is necessary to have some understanding of both the process of consumer choice and the process by which producers respond to consumption decisions and their general economic environment. In the following treatment of these topics, one idea emerges as the key to defining the role and potential benefits of consumer education: the consumer is an imperfect choice-maker not only in purchasing market goods, but also in other dimensions of choice involving the allocation of his/her time and in the exercise of political rights or obligations as a citizen. The role of consumer education is, as we understand it, to provide citizens with the knowledge that would permit them to reduce these imperfections.

The basic principle of welfare economics states that marketplace choices by perfectly well-informed rational consumers maximize the economic welfare of society when all goods are produced under conditions of perfect competition, given an optimal initial distribution of wealth. Of course, for numerous reasons, neither the theoretical conditions of demand—that consumers are perfectly rational and well-informed—nor the theoretical competitive conditions of supply are valid in actuality. Thus, consumers choose (to a degree) incorrectly among the set of goods and prices offered, and producers respond incorrectly (from the social point of view) in offering goods and prices in the marketplace. Hence, consumers' sovereignty over the range of economic choices is undermined by circumstances on both the demand and supply sides of the market. Therefore, some collective means of improving the responsiveness of the supply system to consumers' actual preferences seem warranted. In fact, a large number of the activities of government constitute efforts to achieve just such results.

For example, the Food and Drug Administration (FDA) is intended to improve the reliability of information about products and to simplify the consumer's choice problem, especially in instances where the wrong choice could directly cause injury or impair health. There are also a number of regulatory bodies (such as the Interstate Commerce Commission (ICC), Civil Aeronautics Board (CAB), or Federal Power Commission (FPC)) which oversee the major managerial decisions of an entire sector of the economy. These agencies are intended to assure that private producers' actions do not fall too far short of meeting public needs and preferences. As will be discussed in Chapter III, the individual's range of choice is not limited to what he/she will purchase as a consumer and how he/she will earn income but must also extend to his/her activity (or lack thereof) as a citizen in defining government's and industry's role in the supply system. In this Chapter and in Chapter II we examine in more detail the obstacles to consumer sovereignty, concentrating principally on the demand side of the market. The process of consumer choice and the ramifications of private sector advertising will be the main focus of this discussion.

B. Obstacles to Consumer Sovereignty

In a "free market economy," if each consumer has complete freedom of choice in what to do with his/her earnings and wealth, the willingness of individuals to spend their money induces producers (or "entrepreneurs" in the classical phrasing) to provide the goods and services the consumer wants. In the economists' ideal economy, producers, by acting in their own self-interest and by attempting to maximize their profits, will of necessity do what provides the greatest degree of economic welfare for consumers. This construct, known as the doctorine of "consumer sovereignty," is based on a number of assumptions regarding the structure and environment of the marketplace, among which are:

1) Consumer tastes or preferences are "exogenous" to the market. That is, they are determined by factors (heredity, culture, etc.) which are unaffected by the economy. Producers have no influence on these preferences, but simply react to already existing tastes when deciding what type of products and how much of them to supply.
2) Consumers are in possession of "perfect information" regarding the choices available to them. Given their preferences, they know what goods are available and the prices and quality of those goods. This knowledge enables them allocate their resources in a manner which will maximize the benefits from their purchases.
3) There is effective competition among the suppliers of goods and services, so that no one firm has a share of the market for any particular product large enough to significantly affect the price and quantity of that product available to consumers.

It is reasonably clear that in modern industrial society these conditions are far from being met. The complexity and variety of the marketplace makes the task of consumer choice difficult. Whereas it may have once been true that the range of available goods and the attributes of each were readily apparent to the average consumer, this is not the case today. The amount of information needed to make effective decisions on how to spend one's resources has increased tremendously. When resource allocation is viewed as not only being monetary in nature, but also as including the choice of work that gives psychological satisfaction, the distribution of one's time between work and leisure, and the choice of how to use leisure time, making choices can be seen to requires considerable skill.

The failure of consumer sovereignty in practical terms means that opportunities for choice in the marketplace are distorted so that, given the level of use of resources of the society as a whole, more goods or goods better suited to the needs of consumers could be available. The failure of consumer sovereignty can be traced partly to the demand side of the market. Demand for goods and services is derived from the underlying preferences of consumers. These preferences in turn are formed with the aid of information on market choices. This information describes opportunities for choice in terms of what goods

and services are available and what their characteristics are, including price. Inadequate or misleading information causes misguided formation of individual preferences and, to the extent that the lack of unreliability of information is systematic, the aggregates of individual preferences, or market demands, will be misguided.

Information is itself a scarce commodity, and, because of its characteristics, a sound economic argument has been made that, on the whole, factual information is in too short supply. The principal factor accounting for the underproduction of unbiased information is its "public-good" characteristic. This means that the entity providing the data is unable to charge consumers effectively for the benefits they gain from receiving useful unbiased information. Producers of a product or service had, as discussed below, motives for providing biased information. In addition, their incentive to distribute accurate data on the desirable qualities of their products is hampered by the difficulty which consumers face in distinguishing objective from biased information. Particularly when the products are technologically complicated, and so are not susceptible to evaluation by the consumer by simple inspection, the consumer cannot tell whether and to what degree producers' claims are accurate. Thus, the unreliability of information deprives the providers of "good" data from increasing their sales as much as would be desirable. The quality of information is likely to sink to some kind of "lowest common denominator," as firms compete via increasingly outlandish claims for their products.

Third-party disseminators of information face a different but related problem in that, while they may be well-recognized as objective sources, they can, in effect, be "exploited" by consumers. This is particularly true for magazines such as Consumer Reports. Once an issue is produced there is no way of preventing people from circulating the copies, and thus each consumer does not have to pay for the benefits he/she gains. This prevents the publisher from obtaining revenues proportional to the value of the information provided; hence, the amount of consumer research undertaken tends to be less than is socially optimal. Copyright and patent laws help to mitigate these public-good effects, but only to a limited degree.

We therefore take as our starting point the view that theoretical analysis supports the offhand impression that the private market does not supply the quantity or quality of information which consumers need. In the next Chapter we review some of the obstacles to consumer sovereignty and their effects in greater detail.

Turning to the supply side of the market we also find a number of circumstances which prevent producers' incentives from reflecting the preferences of society as a whole. Some of these circumstances seem to be entirely structural; others can be attributed to a lack of information on the preferences of buyers. Here again we observe responses by the public (e.g., regulation) and the private sector (e.g., market surveys) to compensate for structural and informational deficiencies. In Chapter III we examine the supply side in more depth.

C. The Process of Consumer Choice

To examine the implications of improper consumer choice it is necessary to understand the process of consumer preference formation. Of course, no one really knows how individuals make choices on consumption--or anything else--not even the individuals themselves. Conventional economic analysis posits that consumers' preferences are "given." In this view, underlying or intrinsic preferences of the consumer, combined with adequate and reliable information on the characteristics of products, lead to rational, self-interest-maximizing choices. The lack of realism in this formulation has been widely recognized. An alternative-choice paradigm which has gained acceptance in recent years introduces an intermediate level of "consumption characteristics" between the individual and the marketplace. These "consumption characteristics" basically embody the individual's style of relating to the material base of livelihood and leisure. Within any lifestyle, individuals could differ in the relative emphasis they place on certain characteristics: for example, the spaciousness, comfort, and decoration of the living space, and the role of entertainment, such as movies and live music, could be areas of differing relative emphases.

This formulation of the process of individual consumption choice has two components:

- the relative importance, or priority, of different consumption characteristics for any given individual
- the individual's ability to select those goods on the market which will best serve his/her consumption priorities

The former component relates to the formation of attitudes to consumption and lifestyle--the individual's conception of a happy or satisfactory style of life. The latter component makes use of information on product characteristics. Both components are systematically affected by the quality and quantity of information available to individuals as consumers.

Five interrelated types of inadequacies in the consumer information system can be distinguished:

1) inability of consumers to find or to use effectively that information which is readily available
2) the lack, or difficulty, of obtaining data with which to make comparative decisions among goods
3) the provision by firms of biased or deceptive information
4) the ability of firms, through intensive, repetitive, and persuasive marketing techniques, to influence the tastes and desires of consumers
5) the effect on special classes of consumers, in particular children, who are not able to evaluate adequately the objectivity and truthfulness of information.

While the existence of all these problems is widely recognized, their extent and importance in relation to particular industries or particular goods and services is a subject of great controversy. Only the first category can be excluded as a source of pronouncements of innocence by the business community. This is because it relates not to characteristics of products and conduct of

firms but to the basic skills needed by individuals to make rational choices, basic skills such as reading comprehension, simple arithmetic, and the concepts of credit and insurance. These are obviously closely tied to traditional education, and industry has offered little objection to the idea of improving these consumer capabilities. The benefits here from consumer education, as distinct from the standard course materials, are dependent on 1) the extent to which people do make incorrect decisions, given their preferences and the information available to them; and 2) the degree to which poor judgments are attributable to a lack of opportunities for specific programs that teach consumer skills, as opposed to deficiences in more standard subjects. If individuals do not obtain a reasonable familiarity with the "3R's," they will have as much difficulty comprehending consumer education materials as they have understanding the marketplace.

All other categories of market failure regarding information flows involve the possibility of conflict of interest between sellers and buyers. That is, the type and amount of product data which consumers desire to receive from producers is significantly different from the information which producers, acting as individual profit-maximizers, find in their self-interest to provide. A large body of opinion still asserts that competitive pressures will, in general, force firms to act in the best interests of consumers. Our hypothesis is that, to the contrary, there is a systematic deviation of the information system from what would be socially optimal. Since satisfaction is so difficult to quantify, the effects of a hypothesized bias in the provision of information are virtually impossible to show in a direct, objective manner. Instead, indirect and/or subjective measures and theoretical results that would be expected and the empirical work that has been done both to support and reject the hypothesis.

There are a multitude of sources of information on the characteristics of marketplace goods and services. Most of these derive from the experiences of everyday life. The adequacy and bias of information from these sources obviously depends crucially on the receptivity and perceptiveness of the individual and defies systematic evaluation. Consequently, in Chapter II we will focus on advertising as the prime institutional source of consumers' information. We will view advertising as an instrument to promote the interests of producers, which are likely to diverge greatly from those of consumers.

II. THE ROLE OF ADVERTISING

A. Introduction

Evaluating the social costs and benefits of advertising would be a very ambitious undertaking. To do so responsibly requires making explicit and rationalizing some important judgments and assumptions. For example, some benchmark of what constitutes adequate information for consumption decisions seems necessary. There are widely varying opinions and evidence on just how susceptible people are to persuasion and indoctrination of values through advertising. Nonetheless, it seems that in qualitative terms an understanding of the potential social costs and benefits of advertising supports the view that society should further pursue means to improve the quantity and reliability of information available for consumption decisions.

To the extent that advertising conveys reliable information on product characteristics and contributes to increased awareness of the range of consumption choices, it confers social benefits. Everyday experience confirms that much of advertising is useful, providing consumers with knowledge of what products are available and their current prices. When advertising acts to reduce the costs to consumers of finding out about changes in the market, it serves to enhance market efficiency, lowering prices and costs, and increasing welfare.

Determining in what contexts advertising fulfills an informative function ("informative" herein will mean unbiased information) and to what degree it does not has been a prime concern of researchers. There is fairly general agreement that advertising in producer-goods industries, for example, advertising by manufacturers of printing presses, office furniture, and structural shapes, is primarily informational in nature. The purchasers know rather precisely what they expect to obtain from the product and are usually either making large expenditures or frequently repeating their purchases. Also, in many cases sellers provide a uniform product (for instance, steel sold to automakers). Thus advertising of this kind serves to reduce the "search costs" of buyers.[1,2]

Within the consumer goods sector a reasonably accurate distinction can be made in most cases between advertising by retailers and advertising by the manufacturers of products. Much retail marketing is highly factual, often just stating the good for sale and its price, as in the case of classified or supermarket ads in newspapers. Here it is clear that consumers are greatly aided by advertising, which serves essentially as a communications mechanism. There are exceptions: some advertising by car dealers, the advertising of lowest-price ends of product lines followed by salespersons' efforts to divert consumers to higher priced items, and incomplete or misleading representations of warranty and credit terms. Producers on the other hand have a greater incentive to promote their own particular product and, as will be discussed in the next section, are unlikely to provide much unbiased data.[3,4]

Having narrowed the subject matter primarily to advertising of consumer goods by the manufacturing sector, we still face difficulties in separating out informative components from those that are misleading and/or persuasive. Magazine ads and radio and television commercials contain both information which simply lets consumers know of the existence of products and, at the same time, attempts to persuade consumers of the products' desirable attributes. Thus, individuals are generally unable to receive informative data without being exposed to psychological marketing techniques. It is frequently true that the two sides of the information system--beneficial and undesirable--are supplied jointly.

Of equal importance are the institutional arrangements by which consumer goods advertising is almost always provided in conjunction with entertainment. Included as an inseparable feature of mass media programming in this country, advertising competes for the viewer's attention with other consumption possibilities that are available at the same time. The resultant mode of advertising is designed not to inform, but simply to cause the consumer to associate a product with a particular brand name. Thus, the nature and limitations of the present media channels used for advertising severely restrict its form and functions. A subject for further research, which we will not pursue further here, is whether new systems of mass communication, such as cable television, might result in more informative types of product promotion. Another problem not taken up here is the effect of the commercialization of radio and television on the program content of the entertainment they provide.

Confusion between the two facets of advertising has caused researchers to reach erroneous conclusions. For example, Benham compared the prices of eyeglasses in states which allowed advertising of eyeglasses to those in states which prohibited it. It was found that average prices were twice as high in those states where advertising was not allowed.[5] These results clearly demonstrated that objective data not only has great benefits for consumers but is virtually essential to effective market choice. However, it does not, as has been claimed, support the viewpoint that some forms of advertising or all advertising on balance do not impose large net costs on the economy.

B. Social and Economic Costs of Advertising

There are three general categories of social cost attributable to the commercial advertising of goods and services:

- it can provide misleading information on price and product characteristics
- it can systematically influence the formation of preferences
- it can enhance market power and/or distort competitive incentives.

Of these three types of social consequences we find that the second is theoretically, and quite possibly in practice, the most important. As stated earlier, for a free market economy to optimize economic welfare, it is

necessary, among other things, that the tastes, preferences or "cultural values" of consumers be determined outside the economic system. Once it is admitted that marketing by industry, and advertising in particular, can affect peoples' tastes, there is no longer any reason for assuming that increases in consumption raise welfare levels in society. In fact, if a large proportion of advertising is successful in molding preferences, which large advertisers presumably believe to be the case, it is quite possible that higher consumption is actually accompanied by reduced well-being.

We find it convenient below to explain the three forms of social costs by means of their manifestations in the economic system. These manifestations are divided into five categories. Misleading information by competing firms can result in some form of random consumer "mistakes (in terms of what the individual expected to receive in making a purchase) which impose social costs but are not in the aggregate identifiable in the economy. However, misleading advertising can also have effects which systematically distort market structures, harming consumer welfare by reducing competition and thus making industry less responsive to the consumers' desires. Economists have concerned themselves primarily with this first category, which has been most susceptible to empirical analysis by the standard tools of economic theory. Our second classification is the direct wastage costs of expenditures on advertising and on physical product differentiation; for this, also, it is possible to cite numerical cost estimates, although in the case of physical differentiation the difficulties of estimation are great.

The other three categories--effects on the inter-industry distribution of consumption, on biasing consumer choice toward market over non-market sources of satisfaction, and on causing people to evaluate their material welfare relative to others' consumption patterns--all are related to the ability of marketing techniques to influence preferences. None of these effects lends itself readily to measurement (except by complex and ambiguous statistical techniques). That this is true is not surprising, considering the nature of questions; moreover, the conclusions are not invalidated. The combination of theoretical inferences and qualitative evidence provides strong support for the arguments presented here.

1. Market Structure Effects

The most obvious example of market structure effects is probably "meaningless" product differentiation. Such product differentiation depends heavily on advertising and the creation of brand allegiances, which enhance the market power of the firm. It is worthwhile to dwell on the question of product differentiation and advertising.

"Product differentiation" occurs when each producer, through actual modifications of the product and through marketing methods such as advertising, makes that brand "unique," at least to some consumers. That is, consumers no longer regard brands as interchangeable, and a firm can raise its price without losing many of its customers. Successful product differentiation allows the producer to exercise market power--to increase his profits by raising price. Without brand allegiance, raising the price would reduce profits through loss sales.[6,7]

The debate over advertising has centered greatly on whether its ability to create market power can lead to excess profits in an industry which is controlled by relatively few firms. Comanor and Wilson, in their empirical work on advertising and market structure, suggest two reasons for this being the case: 1) Product differentiation and advertising create absolute cost advantages for the early entrants into a market. The initial firms can create a customer "following" which can only be gained by later entrants at greater costs: witness "Frigidaire," "Kleenex," "Thermos"; 2) There are economies of scale in advertising and in differentiating products, with the result that the lowest level of those will only be reached by very large firms, and when few firms dominate an industry.[8] These cost characteristics constitute barriers to entry into the industry that may result in an "oligopolistic" industry, i.e., where output is concentrated among a few firms. Although there are various complicated theories of oligopoly, basic agreement exists that some degree of monopoly power will be exercised--firms will collude, overtly or covertly, to restrict output and thus has two effects -- a welfare gain by producers at the expense of consumers and an "efficiency loss" to society as a whole.

Two other characteristics of highly concentrated industries relate to the insulation of firms from the normal competitive pressures. First, firms under oligopoly tend to keep much less effective control of their costs than do firms in competitive industries. In one case cited by Paul Scanlon, the break-up of a price-fixing conspiracy caused prices to fall by 32 percent, while monopoly profits had only accounted for 9 percent of the higher prices. Second, recent evidence shows that in many instances corporations with market power tend to invest relatively less in technological research designed to improve product quality--inventions and innovation--than do firms in competitive sectors.[9]

Moreover, studies have shown that beyond doing less technological development than competitive firms, oligopolistic corporations actually tend to innovate in directions which are disadvantageous to consumers. These include movements away from price competition, away from product durability, toward production methods which could further raise barriers to entry into the industry, away from lower-cost techniques, and away from outmoding current productive capital and existing managerial and organizational resources.[10]

It has been demonstrated theoretically that product differentiation need not create barriers to entry and oligopoly for there to be a welfare loss. A long-term equilibrium can be reached where there are many firms in the industry, each marketing a differentiated product. None of the firms need be making excess profits, and none of them can raise profits by raising prices. Yet due to differentiation, prices are higher than in perfect competition, firms are not producing at the lowest possible cost, and consumers therefore suffer due to market inefficiency.[11,12,13] In effect, what has happened is that producers compete for each others' customers through the use of advertising and physical product differentiation. These efforts cancel each other out, leaving firms with about the same market shares they would have had anyway. But the costs of non-price competition mean reduced consumer welfare. This market structure is known as monopolistic competition.

A number of empirical studies examine the relationships between advertising, profits, and concentration. In general, this research has left aside the questions of information quality, as being unworkable for statistical analysis, and so has tried to prove or disprove objectively the hypothesis that advertising influences profits and/or concentration. The monopolistic competition case has also been neglected.

Scanlon uses the breakfast cereal industry as one of the more obvious examples of an industry having questionable social efficiency and strong product differentiation. Three firms dominate the market, accounting for approximately 85 percent of total sales. Profits are at extremely high levels, with Kellogg, the industry leader, showing an average after-tax return on stockholder's equity of more than 20 percent, more than double the competitive norm. Product differentiation, as demonstrated by advertising expenditures of about 15 percent of each sales dollar, are among the highest of any industry. Finally, there appear to be no technical or "economics-of-scale" reasons for the high concentration and resulting high profits, as all manufacturing cost savings appear to be exhausted at between 1 and 5 percent of industry output. Thus barriers to entry as a result of advertising expenditures would seem to be the cause of the cereal industry's oligopolistic characteristics.[14]

Yale Brozen argues that instead of acting in conjunction with physical product differentiation, advertising acts to counteract it, reducing differentiation and making industries more competitive. Brozen cites Benham's study (discussed above), using it as an example of the competition-enhancing effects of advertising. We have already pointed out the mistake in this reasoning. Several other single-industry studies are used by Brozen to support his contentions. Among them is one which found that the ban on television advertising of cigarettes made entry of new brands much more difficult, and another which found that post-World War II increases in cigarette advertising resulted from competition among the many more brands on the market.[15] His conclusion that advertising enhances entry and competition is clearly fallacious--it is not new firms, but the oligopolistic firms dominating the industry which continually introduce new brands. In fact, in the cigarette industry, "brand proliferation" is a strategy for preventing entry, protecting the market power and profits of the existing firms.

H. Micheal Mann, through his own study and a survey of others' work, finds that "the accumulated evidence strongly points to the following conclusion: concentration, advertising intensity, and profitability are all positively associated with one another. The combination suggests diminished price competition and concomitant social loss: misallocated resources."[16]

In a study of 20 American industries, Joe Bain found that in consumer goods industries there were substantial economies of scale in promotion and product differentiation, and that in fact such economies were "of at least the same general order of importance...as economies of large-scale production and distribution in giving established market leaders a price or cost advantage over rivals."[17]

Michael Porter points out, as stated earlier, that sales efforts of retailers differ from those of manufacturers. In fact, in those retail areas where persuasive selling efforts are substantial, termed by Porter "non-convenience" industries, the retailer can counteract producers' advertising. Porter therefore divides consumer products into "convenience" goods, where little or no retail sales assistance is provided, and "non-convenience" goods. Running separate statistical tests on the two categories, he finds that there is a strong correlation between advertising and profit rates for "convenience" industries but no significant relationship for "non-convenience" industries.[18]

Kenneth Boyer, beginning with the hypothesis that most advertising by manufacturers is for "goodwill" (persuasive) while in the retail and service trades it is primarily informational, worked out correlations for each group. He found a strong positive relationship between advertising and profitability for the former, and a moderate negative relationship for the latter, thereby supporting the hypothesis.[19]

As part of the most detailed study ever done on advertising, Comanor and Wilson analyze profits in relation to advertising for 41 consumer-goods industries. They find that "nearly 80 percent of the weighted variance across all industries" in profit levels is accounted for by differences in advertising expenditures. Viewing advertising as a proxy "for the product and market characteristics that permit heavy advertising expenditures to differentiate effectively the products of a firm from those of its rivals," they conclude that advertising is a major barrier to entry and thus contribute to high profit levels.[20]

The authors make estimates of the monetary costs of market power due to advertising in the consumer-goods manufacturing sector. Using an advertising expenditures: sales ratio of 4 percent, above which advertising costs are deemed to be excessive and anti-competitive, they calculate that the technical efficiency losses stated as a percentage of value added were 1.7 percent due to excess advertising, 1.6 percent as costs of firms operating at suboptimal capacity, and 0.35 percent due to allocative inefficiency, for a total efficiency loss to society of 3.7 percent. Above this, there is a transfer to oligopolistic producers of 2.3 percent, for a total cost to consumers (as of 1975) of $2.8 billion or 6.0 percent of value added in the consumer-goods manufacturing sector. They also find that these costs are highly concentrated in a small number of industries whose products are subject to product differentiation and that this results in barriers to entry.[21]

Scherer, in his industrial organization text, attempts "guesstimates" of the various kinds of efficiency losses which are a result of the exercise of market power, getting a total of 6.2 percent of GNP, or about $46 billion in 1966, equivalent to approximately $115 billion in our current GNP of over $1.8 trillion in 1976 dollars. A large proportion of this loss is due to factors which are not attributable to defects in the consumer information system, meaning primarily economies of scale in production which lead to oligopolistic industries. The percentage due to product differentiation through advertising is substantial, but is not separated out in Scherer's calculations.[22]

The empirical evidence presented above strongly suggests that advertising is an important cause of monoploy control in consumer-goods manufacturing industries, and thus of excess business profits, misallocated resources, and hindered responsiveness of industry to consumer preferences. Of these effects the last is probably quantitatively most important, as oligopolistic firms keep poor control of their costs, invest inadequately in technological research, and innovate in undesirable directions.

One important qualification must be made. Statistical correlations can imply any number of different causative sequences, not necessarily the one we have posited here, from advertising to concentration to profits. Mann and Camanor and Wilson, among others, point out a theoretical explanation for a difference sequence. Concentration in industry, as we have stated, is largely due to causes other than advertising. This in turn results in high profit levels; this fact implies a higher profit for every additional unit of the good sold. In such circumstances there is a greater incentive in oligopolistic relative to competitive industries to increase one's sales, and a primary method of doing so is through advertising. Thus, causation can run from concentration to profits to advertising.[23,24]

It seems fairly clear that what is operating in reality is circular causation, whereby both sequences are true and reinforce each other--intense advertising causes excess profits, and excess profits cause intense advertising. Our conclusion is unchanged--misleading information provided to consumers is an important source of market structures which tend to diminish consumer welfare.

2. Direct Wastage--Expenditures on Advertising and Physical Product Differentiation

The costs to the economy of spending resources on advertising itself are substantial. Scherer guesstimates that about one-quarter of the expenditures on advertising in 1966, or 0.5 percent of GNP, "went into messages which served little function but to mislead the consumer or cancel out rival messages," and that another 0.5 percent of GNP was spent on other forms of dysfunctional marketing and style changes, for a "total annual expenditure on wasteful promotion (that) could not be less than one percent of GNP."[25] In current terms this is equivalent to about $18 billion annually.

This discussion of advertising and its consequences has not considered the role of physical product differentiation--making a product seem unique not only through telling consumers that it is different, but by making it look different, by giving it physical characteristics which distinguish it from other brands of the same general quality. Physical differentiation is usually not in and of itself an information problem, except to the extent that physical characteristics can themselves be misleading. However, it is clear that advertising in large part depends upon physical uniqueness, via packaging and superficial product attributes. To the extent that the costs of physically differentiating brands are non-functional in regard to their recognized purposes, these costs are legitmately considered resource wastes.

Separating functional from non-functional characteristics is very difficult and a controversial matter. There are no objective standards by which to determine those traits which raise consumer welfare and those which simply aid in misleading consumers. Certainly differentiation results in a greater range and variety of products on the market, thus tending to benefit purchasers. Nevertheless, it is evident that a large proportion of the expenditures on brand uniqueness in consumer-goods industries is wasteful; limited attempts have been made to quantify these costs.

Fisher, Grilliches, and Kaysen did a study entitled "The Costs of Automobile Changes since 1949." Using 1949 as a base simply because that was the first year for which the necessary data were available, they:

> ...concentrate on the cost of the resources that would have been saved had cars with the 1949 model lengths, weights, horsepowers, transmissions, etc., been produced in every year. As there was technological change in the industry, (they) were thus assessing not the resource expenditure that would have been saved had the 1949 models themselves been continued but rather the resource expenditures that would have been saved had cars with 1949 specifications been continued but been built with the developing technology as estimated from actual car construction cost and performance data.[26]

The authors find that the cost of model changes "came to about $700 per car (more than 25 percent of purchase price) or about $3.9 billion per year over the 1956-1960 period." This is equivalent to approximately $14 billion in current terms.

Beyond construction costs there are costs due to accelerated obsolescence, high costs of parts and repairs, and higher gasoline consumption. Looking only at the last item, it was estimated that additional gas costs were about $968 million per year over the same time span. In sum, "We thus estimated costs of model changes since 1949 to run about $5 billion per year over the 1956-1960 period with a present value of future gasoline costs of $7.1 billion. If anything, these figures are underestimated because of items not included."[27]

The extent to which style changes were for "cosmetic purposes is indicated by a statement made by a vice president of Ford Motor Co., who said that of the approximately $400 million spent on retooling to put out its 1955 line, 72 percent went for body and front-end components (the main style items) while only 28 percent was for chassis and engine tooling.[28]

3. Inter-Industry Misallocation of Resources

Up to this point we have been considering primarily the effects of information differences on consumer choices between different brands of the same product. This emphasis is in accordance with most writing on the subject of consumer decisionmaking, which assumes that the manner in which individuals

choose to allocate their income between different types of goods is determined by basic physical needs for survival and by their tastes and values. The latter are held to be a result of cultural patterns, characteristics of the individual involved, and other factors which are not readily influenced by the information presented in the marketplace.

A large proportion of consumer incomes is still spent on basic living requirements, especially on lower income levels, and it seems clear that these expenditures are not greatly subject to outside influences. However, in the United States for a majority of the population, income is high enough to make possible a substantial amount of discretionary spending. Even considering the necessities, for most people the amounts of money spent on food, clothing, and shelter are above the minimally adequate requirements. It is thus not unreasonable to suppose that the choices between more expenditure on clothing and more shelter, etc., can be influenced by the information that consumers are exposed to.

When we look at purchases of home furnishings and appliances, automobiles, entertainment, vacations, etc., the extent to which spending is a matter of tastes becomes readily apparent. To say that these tastes are determined by culture, not by the marketing techniques of producers, is a refusal to recognize the reality of modern society. The media and its ever-present advertisements, especially in the form of television commercials interspersed between entertainment, constitute a substantial cultural influence. We believe it is clear that advertising affects not solely the choices among largely interchanageable brands of the same general product, but also the decisions made by consumers on where in the broad range of available items to make their expenditures.

The media, and television in particular, extend the vision of consumers beyond their own neighborhoods and social and economic classes. People are exposed, both through the entertainment programming and through commercials, to a graphic description of what is put forward as the "good life." It takes little perception to see that the intent of much advertising is to impress upon people what consumption patterns are maintained by those who have "made it" in society. In a desire to improve their own welfare and status, consumers are likely to be heavily influenced by what is presented to them as the desirable way of life. In their daily activities consumers generally see only a small number of people and living situations. Through the media they are exposed to what may appear to be the lifestyles of that vast majority of society with whom they have no direct experience. Thus, advertising can present a biased viewpoint of what the world is like and what purchases will lead to greater welfare. It can induce consumers to misallocate their resources, shifting their expenditure patterns toward those industries whose products are susceptible to effective promotional activities.

Comanor and Wilson extend their analysis of advertising's effects to consider the impact on total industry demand (or market demand, as they term it). To separate the specific influences of advertising from all other

factors which affect, over time, the demand by consumers for a product, is a task fraught with conceptual and practical difficulties. The statistical manipulations which the authors go through to justify their attempt is too complex for discussion here. From their results they conclude:

> ...the magnitude of the effect of an increase of one percentage point in the advertising: sales ratio is typically much greater than the magnitude of the effect of a one percent reduction in price...Hence the argument that advertising serves merely to allocate spending between brands within broad groupings of products is called into question by these results. If anything, advertising comes through as a more important determinant of the inter-industry allocation of sales than are relative prices.[29]

These statistical findings support our theoretical and qualitatively empirical argument that advertising strongly influences consumer preferences and thus buying patterns. Comanor and Wilson's suggestion that advertising affects purchasing decisions more than do relative prices indicates that biases in the information system invalidate the assumption that higher consumption is accompanied by greater levels of economic welfare.

4. Bias Towards Market Sources of Welfare

A further step can be taken in the analysis of advertising. Above it has been hypothesized that marketing by individual firms, which is presumably intended primarily to affect their shares of a fixed market for the industry's product, has the external effect of increasing the total market for themselves and their competitors within the industry. Extending this reasoning, it may be that advertising can affect not only the inter-industry allocation of sales but the total expenditures for all goods by consumers. In other words, income can be either consumer (spent) or saved. Advertising could bias the decisions of consumers toward increasing their consumption at the expense of saving. In addition, an individual's time can be allocated among earning an income, leisure, and non-income-earning work. Advertising may bias that decision in favor of seeking greater earnings (in order to be able to consume more) rather than toward leisure.

Taylor and Weiserbs, in an article entitled "Advertising and the Aggregate Consumption Function," conduct an empirical test of the idea that advertising stimulates consumption as a whole. They find that the evidence does suggest a strong positive impact of advertising upon consumption. With consumption as the dependent variable, their results that "...a one dollar per capita increase in advertising expenditures is estimated to lead to an increase in per capita consumption of about $4.55 in the short run and $7.85 in the long run." With savings as the dependent variable, "the short run effect of a dollar increase in advertising is to reduce savings by about $4.10."[30]

Thus advertising appears to persuade consumers, as one would expect, that the available products on the market today are so desirable that it is worthwhile to reduce one's savings, and therefore future economic welfare, for the sake of present consumption.

We have assumed consumer income constant and considered its distribution between present and future consumption. But if advertising creates increased desire for material goods, consumers will attempt to increase the funds they have available for market purchases. They can do so by devoting more time and effort to income-generating work, and by obtaining control of income which is not available for spending on market goods and services (e.g., taxes). Such shifts must come at the expense of other uses of their resources, all of which generate consumer welfare, but which do not have significant advertising on their behalf.

Tibor Scitovsky discusses the various categories of human welfare which do not show up in GNP or Net National Product (NNP):

1) self-sufficiency--services and satisfactions which an individual provides for himself or herself
2) mutual stimulation--pleasure gained from interaction with other people, in such forms as casual conversation and amateur sports
3) external benefits and nuisances--most well-known of this category are the diseconomies due to pollution and urban crowding. Positive externalities would include those obtained by a homeowner when a neighbor renovates the outside of his/her home
4) non-market goods and services--these consist largely of household chores and intra-family services, such as cooking and cleaning
5) satisfaction or dissatisfaction from work--numerous studies have shown that labor can range from being very unpleasant to providing a major source of utility.[31]

In addition to these sources are the range of governmentally provided goods and services, which, while included in the national income accounts, are not a direct result of private sector activities.

For our purposes, the significance of this separation (government-provided goods and services from private sector activities) is that none of the above categories of welfare is promoted, in general, by profit-making enterprises. (This is only partially true of government, which will be discussed later.) If it is true that the decisions of consumers on how to allocate their resources--their time, money and effort--are affected by the quantity and quality of information available to them, it is apparent that there will be a systematic bias against those forms of satisfaction which are not marketed. Since it is not in anyone's monetary self-interest to emphasize their benefits, the relevant information will not be provided by the market.

For a variety of reasons, not the least of which is the simple fact that it can be fairly easily quantified, GNP has been used as the prime indicator of societal output. As a result, there has been a tendency to downgrade the relative importance of non-monetarized satisfactions. However, statistical work on the subject indicates that GNP in fact does not come close to approximately a measure of total output.

Sirageldin estimated that in 1964 the average value of unpaid output for the American family was $3,929, or about 50 percent of its disposable income. This consisted of 90 percent housework and other types of home production, 5 percent volunteer work, 3 percent time spent on education by heads of families, and service income received from the family's car(s). The results are obtained by using the cost of purchasing these same services on the market.[32]

Sheldon and Moore calculate the "value" of leisure, showing its steady increase in importance over time, with the result in 1966 leisure was worth $240 billion, or about three-quarters of NNP in that year. The authors base their findings on a maximum 78-hour workweek, figuring leisure value as the opportunity cost of the hours of work foregone, and using the average product of time actually worked for the computation.[33]

Nordhaus and Tobin have done a time series study of non-market work and leisure. They show the value of non-market work to be $295.4 billion, in 1965, or about 65 percent of that year's National Income; and the value of leisure to be $626.9 billion, or more than one and one-third times National Income.[34]

There are conceptual problems with all these estimates. For example, in calculating opportunity cost they neglect the satisfaction/dissatisfaction obtained from work (of course, this same problem is inherent in GNP estimates). But they do strongly suggest that non-market welfare components are at least as great as those included in the National Income accounts. The value of leisure corresponds to Scitovsky's categories of self-sufficiency and mutual stimulation, and possibly also externalities, although it is unclear how to classify this last component.[35]

We know of no attempts to quantify the utility or disutility from market work. There is a great deal of literature on the subject of alienation from work. Both the descriptive survey evidence on peoples' feelings toward their jobs, and statistics showing that individuals in the professions, executive positions, and others who are self-employed tend to put in much longer hours than the average worker, would indicate that there is wide variation in the satisfaction that people get from work.[36]

One study found that "negative attitudes toward work" rose from a low of 9 percent for professional, technical, and managerial personnel to 18 percent for clerical and sales people and to a high of 23 percent for service workers. Also, income correlated with work satisfaction—in general the more interesting the job the higher the pay.[37] Another survey, which asked whether the individual would choose similar work again, got 43 percent positive responses for all white collar workers compared to 24 percent for blue collar, with a high in individual occupations of 93 percent for urban university professors and a low of 16 percent for unskilled autoworkers.[38] When asked what they would do if they had two extra hours in each day, "two of three college professors and one of four lawyers say they would use the extra time in a work-related activity. Strikingly, only one out of twenty paraprofessional workers would make use of the extra time in work activity."[39]

It is often assumed that the higher one's income the lower the marginal utility of income, i.e., the less the value of extra income. Yet, the higher income groups are also the ones where people would be happy to put in more hours, even though they are already working more than the average jobholder, and therefore have less leisure time. These results suggest that labor varies from providing large amounts of utility to people in high interest/status occupations, to providing strong negative utility to those with disagreeable jobs; and that satisfaction/dissatisfaction from work constitutes a significant portion of societal welfare. Thus, to the degree that promotional devices influence people, especially outside the ranks of high income earners, to work more hours and at less desirable jobs in the pursuit of income to buy market goods and services, there is a decrease in overall welfare.

The above evidence on the importance of non-market satisfaction is intended to show that even a slight bias toward market goods and services could mean a large misallocation of resources in society. If advertising and other marketing techniques have a great influence on consumer choice of heavily promoted goods, as has been hypothesized, it seems likely that the impact should be at least as great in steering consumers away from uses of their resources for little promoted goods. Marketing not only increases the demand for a particular product, but increases the total industry demand, and in sum creates a distortion in favor of the entire market sector. The extent of distortion is dependent on the substitutability between widely divergent goods, and marketing tends to increase the perceived substitutability of such goods (i.e., television versus casual conversation or reading). Moreover, the bias toward material consumption becomes culturally ingrained and self-reinforcing. Galbraith has argued:

> As society becomes increasingly affluent, wants are increasingly created by the process by which they are satisfied. This may operate passively. Increases in consumption, the counterpart of increases in production, act by suggestion or emulation to create wants. Or producers may proceed actively to create wants through advertising and salesmanship. Wants thus come to depend on output. In technical terms it can no longer be asserted that welfare is greater at an all-round higher level of production than at a lower one.[40]

Scitovsky believes that producers have a strong influence over consumer preferences (although he feels it is through channels other than advertising),[41] and analyzes our bias toward market goods in terms of a comparison between the United States and other advanced nations. One example is the low regard in which housework, and other consumption skills (i.e., intelligent purchasing behavior) is held relative to production (market work). In other countries the functions of shopping and housekeeping are recognized as important, difficult jobs requiring a range of skills. In the United States, largely due to our induced concentration on market output (no producer will promote the use of our time as effective consumers instead of as wage earners/reckless purchasers), little emphasis is put on the non-monetarized benefits of work in the home.[42] And shifts in the labor force from home to market work show up as increases in GNP, even though they may constitute a misallocation of resources.

Governmentally provided goods and services (leaving transfer payments aside for the moment) do have a promotional constituency (government employees, politicians, and firms that get contracts). But as Galbraith argues in his hypothesis of the "social balance," there is a great bias toward private over public spending. Advertising operates almost exclusively on behalf of private production; and the attendant biases have forced politicians, conservative and liberal alike, to denigrate governmental expenditures:

> The competition is especially unequal for new products and services. Every corner of the public psyche is canvassed by some of the nation's most talented citizens to see if the desire for some merchantable product can be cultivated. No similar process operates on behalf of the nonmerchantable services of the state. Indeed, while we take the cultivation of new private wants for granted we would be measurably shocked to see it applied to public services. The scientist or engineer or advertising man who devotes himself to developing a new carburetor, cleanser, or depilatory for which the public recognizes no need and will feel none until an advertising campaign arouses it, is one of the valued members of our society. A politician or a public servant who dreams up a new public service is a wastrel. Few public offenses are more reprehensible.[43]

Moreover, as public goods, most government spending cannot be charged directly to the beneficiaries (parks, streets). As a result, the question regularly arises as to how the expenditures will be paid for. Thus, due to a "collateral but irrelevant" issue "the money is frequently not appropriated and the service not performed."[44]

In sum, then, the overwhelming emphasis in American society on market production and consumption is a result of the incentive that sector has to promote itself. The other perhaps equally important and potentially more important forms of increasing societal welfare do not have such an incentive. Peoples' apparent preference for market goods is not inherent but is a result of imbalance in the information available to them. As a force to help people become aware of 1) how they are affected by marketing techniques, and 2) the normally downplayed benefits from non-market satisfactions, consumer education, in a broad sense, could have a significant impact on the way in which people allocate their time, money, and effort.

5. Interpersonal Relations and the Distribution of Income

Frederick Scherer states:

> The approach of much advertising and style differentiation is to lead the consumer into making introspective comparisons between his own well-being and that of people he admires or would like to emulate. He is told he stands a better chance of attaining the status to which he aspires if he follows the example of consumption pacesetters or becomes one himself, and in the more blatant assaults,

> that his current status is endangered by not consuming what the "right" people consume. Translated into economic jargon, advertising seeks to make the utility of any given consumer depend not merely upon the goods and services he himself consumes, but also upon the consumption decisions of his peers. It renders utility fuctions interdependent, generating external diseconomies in consumption. To the extent that it is successful in doing this, advertising can destroy utility along with creating it. To be sure, by responding to the stimulus and buying an advertised product the consumer may feel he is gaining something worthwhile. But it is not clear he has done any more than return to the satisfaction level he would have maintained with no attack through persuasion on his preference structure.[45]

In other words consumers are led to evaluate their own material welfare not in relation to some objective standard of fulfilling first the necessities and then becoming increasingly better off as luxuries are added on. Instead they evaluate their material welfare in a totally subjective manner relative to everyone else's purchases of goods and services.

John Maynard Keynes once stated that consumption needs which result from comparisons with other people "may indeed be insatiable, for the higher the general level the higher still are they."[46] James Duesenberry, in his Relative Income Hypothesis, recognizes that the drive toward higher relative consumption has become culturally ingrained: "...the desire to get superior goods takes on a life of its own. It provides a drive to higher expenditure which may even be stronger than that arising out of the needs which are supposed to be satisfied by that expenditure."[47]

Survey data confirm that peoples' levels of happiness are closely related to their relative incomes. Responses to one survey showed that the number of individuals who consider themselves "very happy" rose steadily from 20 percent for those with incomes under $1,000 to 53 percent for those with incomes over $15,000 (greater satisfaction from work may account for part of the trend).[48] However, comparisons over time, in surveys conducted from 1946 to 1970, yield approximately the same distribution of respondents who say they are "very happy," "fairly happy," and "not very happy"—although real per capita income rose by 62 percent over this period. These results would seem to indicate that, at least in the United Stated, welfare levels are unrelated to absolute income, but are a direct function of one's status in the societal income distribution.[49]

We thus have substantial evidence that by making utilities interdependent, by modifying consumer preferences in such a way that one person's increased welfare detracts from another's, advertising has in a real sense negated the beneficial effects of a steadily growing national income. Again we see that the ability of advertising to act in a persuasive manner invalidates the claim of increased consumption to improve economic welfare.

Moreover, this finding implies that persuasive marketing acts as a barrier to changing the distribution of income. A standard argument in favor of promoting growth of the GNP has always been that redistribution from the upper to lower income segments of society is only politically feasible if

there is a growth surplus each year. Upper income people will be willing to give up part of their resources if those resources are regularly increasing, but not if their level of consumption must fall as a result. But if welfare levels are viewed by individuals in relative terms, all individuals except those at the very bottom will necessarily object to any progressive income transfer scheme because it threatens their status in the societal income distribution. Thus great income inequalities, with all their attendant social costs which we need not document here, will be perpetuated.

This conclusion is supported by evidence which shows that the distribution of income in the United States has remained virtually the same since World War II. Although median income (in 1974 dollars) almost doubled, from $6,691 to $12,836 per family, the share of total earned income received by the lowest fifth of the population only increased from 5.1 percent in 1947 to 5.4 percent in 1974. During the same time span the share received by the highest fifth fell from 43.3 percent to 41.0 percent, while the shares of the other segments all remained relatively constant.[50] The share of wage and salary earnings received by the lowest fifth fell from 2.6 percent in 1948 to 1.7 percent in 1973, and for the second fifth it fell from 8.1 percent to 7.8 percent.[51] Moreover, the distribution of wealth is even more unequal. In 1962 the lowest 25.4 percent of the population had no family assest, while the top 18.7 percent held 76.2 percent of the total privately held wealth. The top one-half of one percent of the families owned more wealth than the bottom 81 percent.[52]

C. Summary

In this chapter we have considered the role of product differentiation, as manifested in advertising and superficial product characteristics, in the process of consumer choice. Advertising by manufacturers is the major source of information on consumer products, yet its intent is to benefit the producer, not the consumer. The difficultly of distinguishing accurate from biased information, and the public-good nature of objective product information, largely negates any incentives that manufacturers themselves or other private-sector bodies would have to supplement normal advertising with data more useful to consumers. As a result, the information provided deviates greatly from that which would promote effective consumer decisionmaking.

Advertising both misleads people as to the attributes of goods and services and, through persuasive techniques, substantially molds consumer preferences. The consequences of these two functions are a number of serious distortions in the economic and social systems. First, varying degrees of monopoly power are created in many industries, causing efficiency losses, income transfers from consumers to producers, and, most importantly, a lack of responsiveness of the industries to consumer desires. Second, expenditures on uninformative advertising and non-functional physical differentiation cause substantial direct waste of resources.

Third, and in our view most serious, consumer preferences are affected in ways that imply large-scale distortions throughout the structure of society. Consumption is shifted toward those industries whose products are most susceptible to persuasive marketing. Savings (and therefore future consumption)

suffers relative to current spending. Allocation of resources toward public goods, including such crucial areas as environmental protection and municipal services, are restricted well below the levels that would be socially desirable. Individuals obtain much less satisfaction than they could from non-market activities, including leisure time and household work. Employees derive greatly reduced satisfaction from their jobs due to pressure to choose occupations yielding the highest monetary income. And finally, interpersonal differences in consumption levels are viewed in such a competitive manner that one person's gain appears to be everyone else's loss.

In sum, advertising is a prime contributor to a state of society in which it is reasonable to suppose that unlimited increases in national wealth as measured in the marketplace will have little or no positive effect on the overall level of welfare. An effective program of consumer education could have a major benefit in reducing some of these social costs.

III. CONSUMER SOVEREIGNTY AND THE SUPPLY SYSTEM

A. Public Responsibility in the Supply System

We have been considering the various ways in which consumer decisionmaking is hampered by defects in the information system and have seen that there are far-reaching impacts on the allocation of resources and the level of consumer welfare. The problems we have been discussing have a unifying characteristic: they all relate to the individual decisions made by consumers and thus, in theory, could be rectified by programs designed to improve the choices made by each person.

However, a full conception of the role of consumer education must reflect the fact that the choices available to each consumer are constrained by factors which cannot be influenced by individual purchasing decisions. That is, the degree to which the supply system serves consumer interests is limited in ways which can be affected only by group action, aimed either directly at the producers of goods and services or toward the conduct of government. As mentioned earlier, the general rationale for public involvement in the supply system arises because private incentives may, for a number of reasons, impair or even systematically undermine the fulfilling of public preferences or needs.

In a large national economy such as ours in the United States, there are seemingly numberless specific instances of distortion of producers' incentives, or "market failure," i.e., factors inhibiting the market from maximizing social welfare. For the purposes of this study, we refer to the following general categories of market failures:

- those induced by the technological conditions of production or of distribution
- those brought about by the market power, or political influence of economic agents, whether they be buyers or sellers
- goods which must be produced by the public sector in order to allow adequate oversight and control of production, or for which adequate private incentives are lacking.

The last category includes such government-produced goods and services as defense, education, criminal and civil justice, management of public lands, and other common resources. In general the items in the last category are not usually regarded as marketplace goods, though they obviously play a major role in the quality of life and in determining the range of economic choice. The goods in the first category are typically more easily recognizable as marketplace commodities than those in category three. Technological economies of scale and indivisibility in some lines of production can lead to natural monopoly situations. For example, in the transmission of electric power, natural gas, private line telephone service, or cable TV programs, it would be wasteful to have multiple facilities operated by competing companies. Thus a single company often is granted monopoly operating privileges and conducts business under government regulation. In this way, the behavior of the monopolist can be controlled so that excess profits and inefficient management of production can be limited to acceptable levels.

Large sectors of the economy operate under joint government and private control. In the transportation sector, for example, there are elements of each of the three categories of market failure mentioned above. There are economies of scale which lead to large firm size and hence relatively few firms. There are opportunities for exploiting market power by fixing prices or by market agreements limiting competition. Also, the large investments of land and significant environmental degradation associated with rights of way and fixed capital infrastructure in highways, railways, waterways and airports merit some degree of public oversight. Hence the transportation sector operates under a complex system of limited monopoly and government regulation. Another example is the food sector, which, at all stages of production (including transhipment), is heavily conditioned by government regulatory activity. Because of the extensive involvement of government in the economy at large, a significant share of our production must be earmarked as resources of government rather than used for the satisfaction of purely individual wants. To the extent that government performs the function of satisfying his private wants, part of the individual's tax burden represents a deadweight loss. The effects of market and political power as exercised by economic interests, e.g., large corporations or labor unions, can undermine individual well-being by decreasing either the efficiency of government activity or the efficiency of individual choice in the marketplace. Apart from the obvious consequences of market power--excess profits, excess costs (resulting either from inefficiently managed production or from artificial product differentiation), reduced purchasing power of the consumer, restricted levels of output--there is also the possibility of exercising some degree of control over the surrounding economic and political environment.

Actually it is necessary to look beyond the individual industry for evidence of monopoly power, and the concept "monopoly power" may not fully encompass economic power. The growing trend to conglomerate merger allows flexibility of firm behavior which extends beyond that of the conventional monopoly firm. The Federal Trade Commission (FTC) stated in 1948:

> The giant conglomerate corporation may attain an almost impregnable economic position. Threatened with competition in any one of its various activities, it may sell below cost in that field, offsetting its losses through profits made in other lines--a practice which is frequently explained as one of meeting competition. The conglomerate corporation is thus in a position to strike out with great force against smaller business in a variety of different industries.[1]

In addition to their power to engage in anticompetitive activity conglomerate corporations have greater flexibility in accounting and in obtaining financing; as a result they can avoid part of the burden of taxation and financing costs which companies must bear.

Thus there are substantial direct economic incentives for private firms to increase their size and diversity. By doing so they can also increase their political influence. The history of such influence over the market and over the associated functions of government shows that holders of power tend to solidify their position. Institutional arrangements become rigid and (that sector of) the economy becomes much less responsive to social needs, whether they are expressed as market preferences or political values and judgments.

The institutionalization of economic power in the government and investiture of political power in private corporate and labor organizations have become manifest in two major forms: (1) government policies, largely in the regulatory areas, which appear to be more for the benefit of the regulated sector than for the public at large; and (2) the increasing concentration of private sector activity within a relatively few major corporations. Both of these trends may be viewed as an indication that public policy is excessively dominated by large commercial entities.

In this Chapter we discuss some specific examples of governmental activity which illustrate both the extensive involvement of the public sector in the supply system and the excessive influence of certain private interests in the process of setting and administering policy. The areas of governmental activity we focus on are the following:

- antimonopoly activity
- provision of market information
- price regulation of specific industries
- quality regulation

These activities fall into the three categories of market failure mentioned at the onset of this Chapter. Some industry specific regulation derives largely from the special technological characteristics of production of certain goods, such as electric power, but more of it, such as the regulation of truck rates, has no comparable technological justification. Quality regulation pertains to the preservation of certain values, health or environmental quality, for example, which are not normally counted as private market incentives. Similarly, information is a public good for which adequate private market incentives are lacking. Finally, antimonopoly activity is intended to deter private interests from amassing excessive economic and political power. It should be emphasized that these four areas represent a relatively small fraction of the public sector; we are not attempting to survey all government activity. Similarly, even within the areas discussed, the treatment is by no means exhaustive.

Before discussing specific examples, it would be useful to point out that the observed imbalance of private influence in the government is based on logical self-interest, however unfortunate its consequences may be. There is in fact a body of economics literature addressing just this problem. The basis point has been expressed most cogently by Mancur Olsen:

> ...in a large group in which no single individual's contribution makes a perceptible difference to the group as a whole, or the burden or benefit of any single member of the group, it is certain that a collective good will not be provided unless there is coercion or some outside inducements that will lead the members of the large group to act in their common interest.[2]

Thus, a policy which may be of great benefit to society as a whole, but has little effect on the welfare of each individual, will not marshall strong political support unless there are special inducements. A small number of people who are substantially harmed or helped, however, have a strong interest in promoting their viewpoint and may win the political battle. These two processes can occur for a large number of varied policies, with everyone tending to end up worse off.

A corporation or labor union that has a monopoly is able in many instances to gain most of the benefits from lobbying for itself, and so has a strong motive to spend large sums of money to see that government policies are in its favor. On the other hand, interest groups such as restaurant owners or people concerned about a cleaner environment are unlikely to provide themselves with anything close to the optimal amount of lobbying and political activity. Least influential are consumers, who, because they constitute essentially all of society, are highly ineffective in promoting their joint interest. When a matter of public policy pits consumers against an oligopolistic industry (or one which has found a way to force cooperation of all or most members), it is obvious where the advantage lies.

B. Antimonopoly Activity

One of the activities of the government is to constrain the growth of monopoly power. Government, as controlled by the democratic process, should act on behalf of consumers (i.e., the electorate) to counteract the ability of concentrated economic power to impose on them excessive costs of various kinds. Actions against predatory and other monopolistic practices are the responsibility of the Antitrust Division, of the U.S. Department of Justice and of the FTC.

But since the turn of the century the concentration of economic power and the role of conglomerate corporations have been steadily increasing. For example, in 1964 such corporations, with assets exceeding $250 million, owned 42.1 percent of all corporate assets. In the manufacturing sector, whose output constituted 28.9 percent of GNP, these giants had 51.0 percent of the assets.[3] A study by Kaysen and Turner of 1954 data concluded that oligopolistic industries accounted for 59 percent of total manufacturing sales.[4] From 1950 to 1961 the 500 largest industrial corporations acquired 3,404 other companies.[5] The Wall Street Journal recently reported that corporate mergers and take-overs by conglomerates are expected to rise sharply again in 1977.[6]

In the manufacturing sector, industries with four-firm concentration ratios above 60 percent produced 20.7 percent of total "value-added" (contribution to GNP), while those with four-firm ratios above 40 percent produced 41.2 percent of the value-added.[7] The "4-firm concentration ratio," which is the share of sales in a particular market controlled by the four leading companies, is generally used as an indicator of oligopoly power in an industry. Data from 1958 for some industries with sales over $1 billion are:[8]

Motor vehicles and parts	75 percent
Steamworks and rolling mills	53 percent
Aircraft	59 percent
Aircraft engines	56 percent
Organic chemicals	55 percent
Tires and inner tubes	74 percent
Cigarettes	79 percent
Tin cans and other tinware	80 percent
Synthetic fibers	78 percent
Tractors	69 percent

Except for motor vehicles, cigarettes, and some tires and tubes, these industries are not consumer-goods industries but sell their output to other producers. Recalling out earlier discussions of product differentiation, it was found that lack of objective product information is a serious problem in the consumer-goods sector, but that producers are normally well-informed concerning the goods and services they buy. Thus, the market concentrations in producer-goods industries are not a result of inadequate information among buyers, but rather of production scale economies ("natural" monopolies), collusive and/or predatory behavior among firms, historical accident and, in in the case of aircraft and aircraft engines, possible federal procurement practice.

Another matter of increasing concern is the concentration of economic power in commercial banks and bank holding companies. Regulation of banking by the federal and state governments has had the avowed two-fold purpose of mitigating the growth of market power in the traditional lending and borrowing activities of banks and of preventing the development of bank involvement with and control over nonfinancial corporations. Bank holding companies, which are legal entities that avoid many geographic and other restrictions on bank growth, have become the dominant form of corporate organization for commercial banking: "In 1954, holding companies controlled less than 20 percent of U.S. deposits. Less than 20 years later, bank holding companies accounted for 65 percent of deposits."[9] Holding companies can cause a lack of adequate competition in financial markets, with effects including a decrease in the return on savings for depositors, and increased cost of personal and business loans for borrowers.[10]

Interlocking directorates among banks are another potential source of anti-competitive activity in the financial sector. Interlocking directorates between banks and nonfinancial corporations may lead to conflicts of interest when transactions take place between these two types of firms, and may also

result in indirect monopoly control of particular industries.[11] The trust departments of commercial banks which, unlike the banks themselves, are allowed to hold stock in commercial corporations enabling financial institutions to exert extensive economic control. One study found that "In 1969 the ten largest bank trust departments held 36.8 percent of the total trust department assets," and that of 200 large nonfinancial corporations studied, "excluding control by groups of financial institutions, 69 corporations, or 34.5 percent of the sample, were found to be under finanical control.[12] Other research revealed that in 1972 "holdings of common stock by the top four bank trust departments averaged 17 percent of the stock of eight major retail companies, 11 percent of that of four oil companies, 14.5 percent of the stock of 19 industrial companies, 8.5 percent of 20 utilities and 16 percent of 15 railroads."[13]

There are two principal reasons for the poor performance of the public sector in preventing concentration of economic power. First, the laws under which the FTC and Department of Justice must act are too confining. They require a specific showing of anticompetitive violations under criteria which are unrealistically narrow. Second, the task is a very large one, requiring larger legal resources and adequate information. Much of that information is not available.

One prerequisite to legal action against firms is detailed financial information on sales and profits. Yet federal agencies have difficulty in obtaining the necessary data. The Business Advisory Council, a group whose members all represent firms among Fortune magazine's top 150, is in communication with the Office of Management and Budget (OMB) and can be expected to influence the latter in limiting disclosure requirements for corporations.

With the increasing prevalence of conglomerates, joint ventures, and interlocking relationships among companies, it is important to have ownership information on firms. But the Securities and Exchange Commission's (SEC) key document, the annual 10-K financial statements, only have to include the names of owners of 10 percent or more of the voting stock. In major corporations or conglomerates it is rare for any one person or institution to hold that much stock. Moreover, large shareholders often hide their identity behind "street" names, i.e., the name of brokerage or trading houses or code names--such as AFICO, BYECO, and CADCO under which Prudential Insurance Company trades. The FTC has also been unable to obtain statements which break down revenues and costs or profits and losses by each "line of business." Conglomerates such as Ling-Temco-Bought (LTV), with 757 separate companies lumped under seven vague categories, publish consolidated income statements which are virtually unusable.[14]

Apart from the inadequacies of antimonopoly law and the lack of sufficient resources to enforce the law effectively, there is some evidence that the actions of the public sector itself, particularly in industry regulation and taxation, tend to strengthen incentives for concentration of economic power. This is a topic which has not been properly explored in or outside of government but which certainly merits some research.

C. Provision of Information

We have discussed some of the characteristics of advertising as a source of information and misinformation. There are additional information-providing activities in both the private and public sector which should also be mentioned, though they are doubtless much smaller in scale and impact than advertising of consumer products. Government sometimes improves the information available to consumers by imposing some degree of standardization and control rather than by simply disseminating information which the average consumer could not comprehend. Also, the government purchases information in the form of research and development. Government actions in defense of consumers have been based primarily on technological blockages to effective consumer choice. It has generally been presumed that where the characteristics of products and services can be readily determined the consumer can be expected to have sufficient information prior to purchase. An intermediate class of goods is those whose qualities, while not initially obvious, are thought to be recognizable through "experience"--items bought on a regular basis and which do not individually constitute a large expenditure. Purchase of these also are at the risk of the consumer. Public sector intervention has generally occurred for those types of industries where, even after continued use of their products, comparisons of quality are difficult or impossible without specialized knowledge. Regulation has been instituted mostly in cases where there is not only the possibility of inadequate value from the purchase, but also a danger of further costs to consumers in terms of their health, safety, or the loss of an investment.

The Federal Aviation Administration (FAA) sets standards for the manufacture, operation, and maintenance of aircraft and certification of commercial flight staff and airport personnel, on the basis that the "consumer" of air flights is unable to judge safety considerations. The Consumer Product Safety Commission (CPSC) is supposed to do much the same thing for items such as toys, where the class of consumers involved is particularly vulnerable to lack of information.

In financial transactions, another area where it is judged that the general consumer cannot be expected to operate safety without some governmental intervention, the Federal Reserve Board (FRB), other bank regulators, and the SEC impose a great deal of control. The FRB, as a minor part of its regulation of conditions affecting the national money supply and credit, imposes on banks requirements intended to help safeguard consumer deposits. In this same area the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) insure deposits of smaller depositors. The SEC regulates securities offered for sale to the public in interstate commerce. Through "full and fair disclosure" and other requirements, the Commission attempts to prevent the nonexpert purchaser of stocks from victimization by fraud and dealings by "insiders."

The FDA decides what pharmaceuticals will be allowed on the market and what types of food can be sold in supermarkets. It also sets labeling and grading standards, supposedly for their informative value to consumers (although, for example, the division of cheese products into "cheese," "natural cheese," "slices," and "cheese food," seems designed more to confuse than to aid consumers). To find out what those names mean in terms of actual ingredients one must obtain the relevant sections of the Code of Federal Regulations, not a publication with which most people are familiar. In all these areas federal and state involvement has usually taken the form of setting minimum standards and making items or forms of service illegal rather than of simply providing information.

These brief paragraphs have described the announced intent of some types of governmental involvement. The discussion is not intended to suggest that the regulatory practices have in fact, or even typically, achieved their stated objectives but is intended, simply, to indicate the nature and rationale of one form of regulatory activity. In actuality, the government could easily be doing more to improve the availability of information. For example, neither the General Services Administration nor the National Bureau of Standards release the results of their product-testing programs.

In the private sector, by which is meant primarily profit-making enterprises, a wide variety of measures have been taken which provide information to consumers, though in some cases the effectiveness of these measures is questionable. A number of actions have been taken by firms or industries as self-regulation, often under public pressure. These include distribution of literature on how to make "informed buying decisions," the creation of consumer affairs departments to respond to product complaints, and the institution of unit pricing in supermarkets (although this last constitutes retailer responses to producer failures). One specific example is a program set up by Hunt-Wesson foods to provide nutritional information to low income consumers. Local community people were recruited and given training in nutrition, comparative shopping, and food preparation. These "guides" then provided informal counseling in several supermarkets.[15]

Self-regulation by industry with the purported intent of maintaining high standards and protecting the consumer against deceptive, unethical, and incompetent practices is carried out in many service professions, normally via a strong trade association. These professions include medicine, law, and accounting, among others. Some manufacturing industries have standardized product specifications but, due to factors discussed earlier, this has tended to occur more so in the producer goods than in the consumer goods sector.

Despite the largely public-goods nature of consumer information, in some cases private firms have been able to provide useful information as a profit-making (or at least a break-even) venture. Usually, though, it is necessary to mix information with entertainment. Several specialized publications provide significant objective product data; e.g., magazines concerned with

photography, hunting and fishing, and automobiles. The products featured in these magazines are not for passive consumption but, instead, are essential to an activity in which the consumer is expending a lot of time and effort. Books directed at various areas of consumer decisionmaking appear on occasion, such as in nutrition, family medicine, gardening, and different types of recreation.

Consumers Union is, of course, the outstanding example of efforts to better inform consumers. Begun in 1936, it has grown to be quite a large operation, with its major publication, Consumer Reports, having a monthly circulation of 1.7 million in 1976. The annual budget was almost $20 million, with a full-time staff of over 300.[16] While large in relation to the scale of activities of most nonprofit, public interest organizations, it should be emphasized that the funds Consumers Union spends on aiding consumer decisionmaking with objectively derived data are miniscule in comparison to those spent in promotion by manufacturers.

Throughout its history, Consumers Union has put most of its resources into product testing, technically analyzing the attributes of goods. Appropriately, this testing has emphasized those goods and services, such as automobiles and insurance, whose complexity makes them particularly difficult for the individual consumer to evaluate. Increasingly, in recent years, Consumers Union has sought to widen its coverage. This effort includes trying to provide general buying information, independent of brands, for a class of products; providing background information which may help the consumer in deciding how to allocate spending throughout the marketplace; and considering such consumer problems as guarantees and warrantees and the use of credit. It has also discussed on occasion the more general consumer issues, e.g., pollution, tariffs, and governmental regulation.

Although Consumers Union does face the difficulty that its publications are, through libraries and hand-to-hand transfers, public goods and thus bring in less revenue than is socially optimal, they have a major advantage over virtually all other public interest type groups in that they are working with market goods. Some people are willing to pay for Consumer Reports because they gain individually from making better buying decisions.

The private sector also provides information in the form of research and development. Much of its information, when it addresses the public, is, of course, merely a vehicle for rationalizing the economic interests of a particular firm or industry.

Universities are also large sources of new information, the costs of which are borne largely by the public sector. However, it is becoming more and more evident that in some instances, much to the detriment of consumers, the objectivity of academic research and publications has become questionable because of corporate financing of professors and of institutions of higher education. A case in point is the field of nutrition and food science, an

important area of research in light of the range of health problems which have been attributed to the American diet. Harvard University's Department of Nutrition received more than $2 million from the food industry between 1971 and 1974, from such companies as Beatrice Foods, Carnation, Gerber, Kellogg, and Kraftco. The Department's chairman, Dr. Fredrick Stare, is on the board of directors of Continental Can Company (a food packaging firm) and has testified at Congressional and FDA hearings on behalf of Kellogg, Nabisco, Carnation, the Cereal Institute, the Sugar Association, and the Pharmaceutical Manufacturers Association. Stare, in his syndicated newspaper column, has made such statements as "most people could healthily double their sugar intake daily" and "Is there any reason for concern about food chemicals. The answer is no."

The University of Wisconsin's Food Research Institute received $635,390 in 1975 from food, packaging, and drug companies and their trade associations. Its director, Dr. E. M. Foster, is on the board of directors of Stange Corporation (flavorings, colorings, and other food additives). One of his colleagues, Dr. Alfred Harper, chairman of the Department of Nutritional Sciences, has received consulting fees from such firms as Proctor and Gamble, General Mills, and Pillsbury. Professors in the departments of nutrition at the University of Massachusetts, the University of Minnesota, Virginia Polytechnic Institute, and others have refused to disclose their corporate ties.[17]

D. Regulation of Specific Industries

Regulation of individual industries has often come about as a result of certain technological considerations which created a degree of natural monopoly. In these instances an excessive number of firms would be wasteful of resources. Also, it has been rationalized in some cases on the theory that the particular conditions were such that competitive pressures created in market instability which in the end was harmful to consumers. In the regulation of specific industries the maladroitness of government bodies and the co-optation of policy by the regulated parties is most evident. We will mention a few selected examples. Their number could be greatly multiplied.

In agriculture there has been a long history of government regulation, justified on the grounds of 1) assuring a stable supply of food and 2) raising farm incomes. Concerning 1) it is unclear whether there is any need for federal intervention in the market. In any case, the costs to consumers are high. Considering just the dairy industry, freedom of supply is curtailed in several ways. Through the Commodity Credit Corporation (CCC) the federal government buys large quantities of milk, thereby supporting prices, and then must later give away the surplus product or sell it at bargain prices. The Agriculture Department administers federal milk marketing orders, which divide raw milk into Class I and Class II, with only Class I allowed for use in retail fluid milk; and then it limits the amount of milk that can be sold as Class I. This serves to raise total revenues to farmers (but not necessarily their net incomes) and means higher prices for consumers. Finally, many states regulate milk prices at the retail level. Retail chains have on occasion been prosecuted for selling <u>below</u> the legal minimum. In total, these policies serve to substantially raise the costs of dairy products to consumers.

Earlier in this paper it was pointed out that bans by states on price advertising of eyeglasses imposed heavy costs on consumers. Much the same is true in regard to prescription drugs, where the leading pharmaceutical companies work hard to prevent the posting of comparative prices by druggists from becoming legal. This is accomplished through state and federal regulations. The pharmaceutical firms gain because, without price posting, the higher priced "brand-name" drugs are more likely to be dispensed than chemically identical "generic" or chemically named drugs. The result is that (using 1958 data) 22 leading producers had sales of $2.3 billion in drugs that cost only one-third as much to manufacture. Of the remaining revenue, 25.8 percent went to before-tax profits, 24.8 percent to promotional activities, and only 6.3 percent for research.[18] This socially wasteful system is made possible by efforts to indoctrinate physicians into prescribing brand-name items. In the mid-1960's pharmaceutical companies were spending over $600 million annually for advertising directed to physicians concerning prescription drugs--more than $3,000 per doctor, which "far exceeds the combined administrative and teaching budgets of all the nation's medical schools put together." The strategy works--more than 90 percent of prescriptions in the mid-1960's were written specifying brand-name drugs.[19]

Three years ago the Atomic Energy Commission (AEC), which had been under attack for conflicts of interest because it was supposed to both regulate and promote nuclear energy, was eliminated and its functions were split up into the Nuclear Regulatory Commission (NRC) and the Energy Research and Development Agency (ERDA). It was hoped that this reform would encourage stricter regulation by the NRC and more balanced energy development by ERDA.

Unfortunately, it appears that both agencies are still unduly influenced by the giant corporations (General Electric, Rockwell, Kerr-McGee, etc.) which dominate the nuclear energy industry. For example, in June 1976 a referendum was held in California, approval of which would have required the industry to waive federal liability limits for accidents in order to continue building nuclear plants in the state. Shortly before the vote, ERDA sent to California 78,000 copies of a pamphlet which several Congressmen have charged was "blatant propaganda" intended to influence the referendum.[20] The more basic problem is that Congress itself bowed to industry pressure in passing the liability limit (the Price-Anderson Act), which means that in case of a catastrophic nuclear accident, the corporations will be immune to suits above a certain level. Moreover, the federal government has made available, low-cost insurance to the industry to cover accidents within the limits, relieving the corporations of any risk whatsoever and passing the costs on to the general taxpayer. There is little doubt that most consumers are unaware of these potential costs of nuclear energy and of the influence of General Electric, et al., in the governmental process.

In January 1976, Robert D. Pollard, an engineer who was project manager for the Indian Point No. 3 nuclear plant in Westchester, N.Y., resigned from the NCR, charging that safety at the plant was insufficient and that NRC officials disregarded individual staff views. The following month three engineers resigned from the staff of General Electric Corporation's nuclear

reactor division. The three, who had among them a total of 47 years of experience in designing and building nuclear reactors, cited inability to control accidents due to human error, unresolved problems of long-term storage of radioactive wastes, and proliferation of reactors to other countries as the reasons for their dissatisfaction.[21] In October 1976, reactor engineer, Ronald M. Fluggs resigned from the NRC, charging that:

> We are allowing dozens of large nuclear plants to operate in populated areas despite known safety deficiencies that could result in very serious accidents. We are issuing safety evaluation reports that are carefully censored to conceal major safety problems. We are withholding from the public NRC staff technical analyses of a wide range of unpleasant nuclear safety difficulties. We are giving the public glib reassurances about nuclear plant safety that we know lack an adequate technical basis.[22]

In each of the major transportation industries, the government is centrally involved in most major decisions. The ICC and the CAB set rates for service and regulate entry in air, rail, and truck transportation modes. Further, these agencies and the Federal Maritime Administration protect private price-setting cartels from antitrust enforcement. The government also determines to a substantial degree which capital investments will be made in highways, airport, and, recently, in rail facilities. It is quite clear that the transportation sector as a whole is oversubsidized and is also operating inefficiently.[23] In other words we have overbuilt our transportation facilities and then artifically limited their productivity by maladroit regulation. Here again it is clear that special interest groups have successfully co-opted the regulatory agencies, at the public's expense. The public often purchases expensive capital which primarily benefits transportation corporations and some labor unions. Examples of these purchases are inland dams and waterways, and merchant marine vessels. At the same time transportation costs as a whole are higher than they would be if the adverse consequences of much regulatory practice were eliminated.

E. Quality Regulation

The Occupational and Safety and Health Administration (OSHA) in the Department of Labor is responsible for protecting workers from hazards both to their immediate safety and in relation to their long-term health. This protection is particularly important in the case of diseases (e.g., black lung and asbestosis) which have a long gestation period and are due to workplace environmental contaminants. As in other cases, OSHA's activities mainly take the form of prohibitory regulation rather than dissemination of information.

The CPSC devises quality standards for consumer goods which have been particularly hazardous. The commission seeks to establish generalized functional specifications which reduce the hazardous nature of specific products, while still allowing some opportunity for product differentiation.

The largest scale attempt to regulate quality is being made by the Environmental Protection Agency (EPA). Here, again, the agency is charged primarily with promulgating quality standards. An additional function of the agency is to improve the quality of information relating to environmental considerations. That is the purpose of Environmental Impact Statements which are required by federal law and reviewed by EPA. These documents are prepared by a federal agency regarding the environmental impact of its proposals for legislation or other major action which would significantly affect the quality of human environment. Twenty-six states also require Environmental Impact Statements, some of which may differ markedly from the federal law.

The EPA has not been co-opted in any obvious way by special interest groups. In fact it was Congress itself, in structuring the EPA mandate, which yielded to concerted lobbying against environmental laws that could be workably enforced. By limiting EPA to a legalistic stantards approach to regulation, rather than to an approach based on economic incentives (pollution taxes), Congress created a weak agency, whose effectiveness has been limited. The legalistic approach has led to a great increase in environmental litigation and a relatively small decrease in polluting activity.

F. Conclusion

In this Chapter we have reviewed the rationale for collective intervention in the supply system and examined some of the forms which government activity takes. Even from the few examples discussed, it seems apparent that the actions of government directly and indirectly condition the context of private economic decisionmaking profoundly and pervasively. It is this context of decisionmaking which determines the range of economic choice confronting individuals as citizens and consumers. In light of the diffuseness of consumer and citizen interests and the strong interest of specialized constituencies in the process of policy formation, it is not surprising that the effectiveness of the public sector has been undermined. The long-term consequences of this process are two-fold. First, and most obviously, it results in waste of resources and in inefficiency. Second, and more important, it allows certain interests to solidify their dominance both of markets and to some degree of political mechanism. Thus, entities which need not be responsive to economic realities and social and individual preferences are perpetuated. This is contrary to the evolution of a democratic society not only in material but in cultural terms. Of course, there is no way of quantifying such costs, but they certainly exceed any other costs which we may think of.

IV. POTENTIAL BENEFITS OF CONSUMER EDUCATION

A. Introduction

Thus far we have discussed in some detail a number of circumstances, affecting both the demand for and the supply of goods and services, which impair the consumer's sovereignty. We have shown that the role of individuals as active participants in the process of government can have a potentially profound positive influence on the responsiveness of the economic system to collective and individual preferences. In fact it seems likely that the long-term benefit of citizens acting intelligently to influence the conditions of supply would be greater than the benefits resulting from better informed choices by merely passive consumers.

Of course, the inadequacy of, and, indeed, the negative social consequences of the present provision of information on marketplace choices imposes large social costs. But, because of the characteristics of information as a commodity and the limited resources of individuals to obtain and process information so as to choose intelligently, there is no way to avoid such costs completely. That is, it would be overstating the case to reckon all the adverse consequences of misguided choices as true economic costs. At the same time, it seems clear that systematic improvements in the provision of market choice information both by the private and public sector could be made. We envision that such improvements could be made only by government and citizen initiative and action.

Thus, we view the traditional role of consumer education as primarily facilitating more well-informed or more capable passive consumer choice as being too limited. On the whole, the greatest gap in awareness of information available at large seems to lie in the area of citizen action to increase the range of choice through increasing the responsiveness of the entire economic system. The conception of consumer education should be expanded to include the possibility of citizens improving the overall conditions of choice. In this larger concept, the undesirable consequences of private sector advertising and the general shortfall of information on market choices is viewed as yet another area for citizen and government initiative. In fact, it appears to be the special purview of the Office of Consumers' Education (OCE) to take initiative in the area of advertising.

In order to lend more concreteness to our conception of the role of OCE we briefly survey some of the raw material which could be included in a program addressing citizen action--that is the kinds of citizen action which is taking place presently. We also conjecture about the size of the potential benefits in both qualitative and quantitative terms. Finally, we point to some areas of research for appropriately structuring an expanded consumer education program.

B. The Citizen Action Movement

The modern industrial economy is a complex organism, one which even highly trained specialists have difficulty analyzing and understanding. For the individual consumer, whose time is occupied by the daily necessities of working, raising a family, and making consumption decisions, it is an almost insurmountable task to become knowledgeable about a substantial range of retail products or about even one facet of the supply structure. For this reason, citizen action groups of diverse kinds have tended to evolve around a specific issue or range of issues. Even the larger more general groups such as the Nader organization or the Consumer Federation of America have specialized offices addressing certain areas. In this section we discuss briefly some examples of organized citizen efforts to participate in political and economic decisionmaking. Again we mention only a small fraction of the extant citizen organizations, although a more comprehensive survey is something which OCE may wish to undertake.

Protection of the environment has been the field of most intense citizen action during the past decade. Although the environment is not an over-the-counter type of market good, it is a unique and obviously important consumption good. In general we can say that there is no difference between citizen action and consumer action. Water and air pollution, endangered species, destruction of land by strip mining, and the depletion of natural resources have become foci of national attention. This is in part due to the efforts of environmental lobby groups. Among the most important have been Environmental Action, the Sierra Club, the National Resources Defense Council, the Environmental Defense Fund, the Audubon Society, and the National Wildlife Federation. Obtaining their funds through direct-mail membership campaigns, these organizations attempt to compete with the special interest lobbies for the attention of Congress and the Executive Branch. Through their newsletters and other publications they work to create citizen awareness of the relevant environmental facts and political maneuverings, which hopefully then translates into constituent pressure on legislators.

The highly uneven success which environmental groups have had may be attributed partially to the fierce opposition they face from industrial lobbies; but it also is a result of the ambiguity of their claim to always be operating in the interests of consumers or the general public. Because they are providing information detrimental to many particular interests (and even the objectivity of some of the information can be challenged) and are trying to affect public policy, they necessarily face opposition from segments of the public. This has been most evident in the constant conflicts between measures to mitigate environmental degradation and the power and wealth of business but also in the conflicts with the jobs of workers in particular industries. While it is true that environmental protection should not cause higher unemployment in the long run, short-term dislocations do occur and these are of the utmost concern to the jobholders involved and their unions. The short-lived organization "Environmentalists for Full Employment" was an attempt to deal with this difficulty.

An outgrowth of the environmental field which has become a movement in itself is the fight against nuclear power. The groups involved include the ones mentioned above, plus Scientists Against Nuclear Energy (SANE), the Union of Concerned Scientists, the Task Force Against Nuclear Pollution, and innumerable local

coalitions formed to oppose specific plants in a local area. Perhaps more than any other issue this one exemplifies the contrast between unknowledgeable, dispersed consumers and the two or three giant corporations which dominate the industry. Unlike other environmental problems the hazards of nuclear energy cannot be observed on a daily basis by anyone, but can only be explained in abstract, often highly technical, discussions, within which there is much controversy among the scientists themselves. To educate the public about the dangers of unproven safety systems, nuclear materials falling into the hands of terrorists, nuclear proliferation, and long-term storage of radioactive wastes is a formidable job.

Perhaps the most rapidly growing effort is Ralph Nader's expanding network of organizations. Under the general aegis of "Public Citizen" there now exist research groups in Tax Reform, Health, and Litigation; and the Congress Watch. Nader's organizations have now published more than two dozen books and are active on issues ranging from tax loopholes to food additives to antitrust enforcement to Congressional ethics. His "Public Interest Research Groups" (PIRG's), operating as federations of college groups, are spreading into many states. Nader's influence has grown to the extent that at one point President-elect Carter felt it necessary to state that although he would be considering Ralph Nader's viewpoints on several cabinet appointments he did not feel obligated to do so concerning the Secretary of State.

Common Cause has probably had more nationwide publicity than any other organization undertaking to represent the public interest. It has made constant efforts to involve its membership in political activism. Concentrating on reform of the political process, including campaign finance legislation, conflicts-of-interest disclosure, and Congressional procedures, Common Cause has attempted to restrict itself to issues on which it believes there is wide public consensus. That this is not always successful is demonstrated by the opposition of former Senator Eugene McCarthy to the public financing of Presidential elections.

There are, of course, innumerable other citizen action organizations, with a large proportion of them having central offices in Washington, close to the source of federal policy. Examples include the League of Women Voters, the Center for Science in the Public Interest, the National Organization for Women, the American Civil Liberties Union, the American Cancer Society, and the National Taxpayers Union. Our own group, the Public Interest Economics Center/Foundation, is involved in, among other things, education of governmental policymakers and the public-interest community in the economics of various issues through a program of seminars and conferences; it is also involved in education of the general public through our newsletter and other publications.

One of the primary reasons for the founding of the Public Interest Economics Center was the tendency for results of economic analysis to often be counter-intuitive. For example, it is often difficult for citizen groups to realize that their economic objectives, while they may be laudatory, often impose kinds of costs which are not immediately obvious. Also, it is a common error for groups to lobby for ineffective policy tools to achieve their goals. Tax credits, subsidies, and loan guarantees, for example, not only impose direct

costs but also distort economic incentives in other ways. Thus, citizen action organizations often support or oppose policy measures which are demonstrably contrary to their own interest or the public interest. A major role of public interest economics is to further involve economists in the process of formulating citizen groups' policy positions. In fact, it can be very damaging to the effectiveness of citizen groups as a whole when an organization, through lack of information or through improper analysis, promotes an unsound position.

Recently there has been a strong revival of citizen action, or community organizing, on the state and local levels. As mentioned before, nuclear power has been an important facet of these efforts. Perhaps most emphasized has been action against regulated public utilities, particularly electric utilities, since fuel prices began skyrocketing several years ago. In general these local citizen action groups have pressured state legislators, promoted statewide issue referenda, and intervened in individual rate and plant citing cases. The most common recent demands have involved changing rate structures, including elimination of rates which decline as the quantity purchased grows, eliminating discrimination against residential customers in favor of industry, introducing peak and off-peak rates, and instituting some form of "lifeline" rates for small users.

Some of the more prominent organizations are Arkansas Community Organizations for Reform Now, Carolina Action, Wilmington United Neighborhoods, and Massachusetts Fair Share. The more successful groups have extended their work into other areas where city and state governments have a major role. These areas include subsidized housing, administration of social welfare programs (food stamps, social security, etc.), and other services, (e.g., police and fire protection and public education).

C. Sizing the Potential Benefits of Consumer Education

Thus far we have described and substantiated a conceptual framework within which a manifold problem of information availability both circumscribes the range of economic and market choice and reduces the ability of individuals to choose for themselves. Accordingly we see two major areas of potential benefit from a properly conducted and amply funded program of consumer education. These are:

- the benefits of increased citizen participation in those political decisions which ultimately and profoundly determine the context of private economic decisionmaking. Citizen action here could improve the performances of government in its present functions and could introduce entirely new initiatives. These benefits are predominantly long-term in nature.
- the benefits of more well-informed consumer choice. Probably the most potent means of improving individual awareness would be to counteract the systematic biases in preference formation which result from advertising.

It is perhaps more difficult to conjecture about the potential size of benefits in the second category than in the first. Nonetheless some qualitative and quantitative examples can be mentioned which could give some measure of the

potential significiance of consumer education, despite the fact that a large share of the potential benefits could never be achieved by an educational effort no matter how well-conceived or funded. As a first approximation, the potential benefits of citizen action efforts can be regarded as the costs of wasteful practices and policies or positions in both the public and private sectors which redound to consumers' disadvantage.

Presently, the American political system is not effectively resolving a great number of critical economic issues. At the Congressional level the characteristic pattern of action is domination by special interest pressures and biased information typically seeking to perpetuate the status quo or to meet demands of particular producer interests. One consequence is extended delay, during which problems develop largely unchecked, followed by a crisis. Delay in addressing problems can prove enormously costly. For example, for decades the United States railroad industry had suffered from corporate use of rail properties as a speculation vehicle; from confusing regulatory restrictions on rate making and route rationalization; and from dilatory governmental policy on mergers, public subsidies to other modes, and appallingly inefficient arrangements for the use of labor.

It was not until the recent spate of bankruptcies that Congress seriously considered major action. By then the years of physical deterioration of fixed plant had become a severe problem in its own right. The cost of rehabilitating even part of the fixed plant will be several billion tax dollars in the next few years. It is unclear whether even the most sweeping institutional reform could now restore the industry to the productivity it might have enjoyed had action been taken promptly. The consequences of this long-term neglect is the transformation of the rail sector from a vital industry into a growing public burden.

Because Congress typically makes new policy in an environment of crisis, dominated by producer group pressures, legislative mandates to the executive branch often fail to grapple with the basic circumstances which created the crisis. Of course, executive branch and independent agencies cannot function in the public interest if their tasks are implicitly structured to serve the private interest.

It would be useful to cite evidence of further instances where economic reform could yield substantial social benefits. Of course, such instances abound, and we will mention but a few, here divided into four categories:

1) subsidies to interest groups:

- The annual subsidy cost of tax-exempt pollution control bonds "could range from $800 million to as much as $1.5 billion in 1980, with 30 percent or more of the value lost to investors rather than being realized in reduced borrowing costs for pollution control improvements."[1]

- The total annual cost of the inland waterway system is currently running in excess of $400 million. This figure is a reasonable target for user charge recovery."[2] This amount is a direct subsidy from taxpayers to barge operators and shippers under present policy.
- Of the $4.2 billion in tax revenues that the tax exemption for municipal bonds cost the federal government, in fiscal 1976 only about 70 percent or $3 billion got to state and local governments in the form of lowered interest rates on their bonds. About $1.3 billion thus went to wealthy individuals and commercial banks.[3]
- Maritime subsidies are another category of substantial public expenditure, an increasingly wasteful use of public funds which has produced negligible public benefit and retarded technical progress in the U.S. maritime industry.
- Farm price supports and related programs meant a "total transfer from consumers and taxpayers, in the range of $9 to $10 billion," which "compares with a total federal, state, and local cost of various public assistance (welfare) programs, including medicaid, of slightly over $10 billion in 1969."[4] These transfers go mainly to large farmers and landowners, not small struggling farmers, particularly not to tenant farmers.

2) economically inefficient regulation:

- It has been estimated that complete elimination of the backhaul restrictions, along with rate flexibility, would cause truck rates to decline 13 to 15 percent. Output of the industry would rise 7 percent, and there would be a one percent decline in the cost of goods transported by truck to the consumer.[5]
- An analysis of "the Delaware River Basin concluded that, for achieving any given level of water quality, an incentives strategy relying on effluent charges, that concentrated discharge reduction where it was cheapest would cost 40 to 50 percent less than present uniform treatment requirements. A similar gap appears in the costs of the two methods for achieving 85 to 90 percent reduction of BOD among industries in the Great Lakes region. An analysis of the cost of reducing sulfur emissions, which compared the costs of uniform regulation with those of emission charges, found that the latter strategy offered costs savings of over 35 to 40 percent."[6]
- The costs of eliminating pollution go up exponentially per percent of control as the amount of the pollutant in the environment is driven down to zero. The EPA once estimated that removing 85 to 90 percent of all industrial and municipal water effluents would cost $61 billion over the 1971-1981 decade. Increasing removal another five to ten percent to the range of 95 to 99 percent would cost $119 billion, or 15-20 percent of GNP.[7] Yet some federal laws are written to use "best available technology," with the goal of total removal of pollutants.
- CAB regulation of domestic air transportation has led to inefficient patterns of innovation and costly service competition. The result has been to deny consumers the potential benefits of price competition without conferring desirable benefits on carriers. Unregulated air fares would probably be no more than 2/3 or 3/4 of present fares in major markets, possibly less.

- "It is therefore fair to say that the social costs of economic regulation of (surface freight) transportation may have been at a minimum between $3-4 billion in 1969 and higher in subsequent years as freight revenues, ton-miles and GNP have risen...it appears that net social costs may approximate $4-5 billion and that the identifiable beneficiaries benefit, if at all, by redistribution from others."[8]
- The FCC's regulation of cable television has effectively prevented the industry's development.

3) governmental process:

- Though much attention has been given to reducing over-all military spending and some consideration to cutting specific weapons systems, these efforts have never been refined to address the institutional distortions in the weapons acquisition process. As long as such distortions exist, there will be such massive waste that, in providing adequate defense, individual weapons systems will be gold-plated and over-specified. Total costs of national defense are not included in the budget of the Department of Defense itself ($94 billion in 1976), but include tens of billions of dollars for other items attributable to military spending--foreign military aid by the Department of State, $1.19 billion; weapons-related programs of the Energy Resources Development Administration (ERDA), $1.8 billion; veterans benefits, $15.6 billion; and interest on the national debt, largely attributable to past wars, $26.1 billion.[9]

4) ineffective control of business practices:

- "The staff of Senator Hart's antitrust committee estimates, moreover, that deceptive packaging and promotion in the food industry alone are causing consumers to lose $14 billion a year."[10]
- FTC "has estimated that if highly concentrated industries were broken up by the antitrust laws into more competitive companies so that the four largest firms in any industry would not control more than 40 percent of that industry's sales, prices would fall by 25 percent or more."[11]

The existence of massive implicit and explicit public expenditure subsidies to industry and organized labor and the well-documented role of the regulatory process in protecting the status quo and reducing competitive forces pointedly document the necessity of sustained and serious lobbying on behalf of the public interest. This can be achieved only if citizens become aware of the possible benefits of economic reform and mobilize to accomplish it. The reduced wastage of resources resulting from significant reforms would be a substantial fraction of GNP—perhaps as much as 10 percent, or roughly equivalent to the budget of the Defense Department.

But a more important consequence would be increased flexibility of the economy to respond to technological possibilities, social needs, and individual preferences. The magnitude of these benefits could turn out to be an additional sizable fraction of GNP in the span of a decade.

We have been able to identify no usable estimates of the social costs of advertising that might be reduced by a consumer education program designed to offset the biases and fill in the gaps in the information provided by the commercial media. One can make a crude estimate that provides merely an indication of the magnitude of the direct costs involved:

> In 1968 $17.9 billion was reported as expenditures on advertising,[12] this is equivalent to approximately $38 billion in relation to 1977 GNP. Although some advertising does produce usable benefits, a reasonable calculation would be Scherer's estimate that about 25 percent served merely to mislead consumers or to cancel out rival messages, for an actual social cost of $9.5 billion.

To the extent that the effects of advertising messages were not canceled by competitive messages, some firms gained higher profits by increasing their sales. If we guess that profits were increased by half the socially wasteful expenditures on advertising, then there was a transfer of about $4.7 billion from consumers to producers. The profit margin in American industry generally runs from 8 to 10 percent of the sales dollar, so that the extra profit implies a diversity of $36 billion to $47 billion in sales between firms in the same industry and between industries. This constitutes a misallocation of resources equal to around 2 percent of the GNP. Also, since advertising is considered a legitimate business cost for tax purposes, roughly half the total expenditures on advertising was paid for by the public in the form of reduced corporate income taxes.

Another crude calculation can be made using the figures cited earlier on non-market sources of satisfaction. Leisure has been estimated in value to be 1 1/3 times national income, and non-market work (household chores, etc.) at 65 percent of national income. If we take an extremely minimal guess that satisfaction or dissatisfaction with work is worth one-quarter of GNP, we have a total value for non-market satisfactions of 2.25 times GNP. If the effects of advertising are to bias consumers' decisionmaking so that there is, say, a one percent shift of their expenditures of time, money, and effort toward marketed welfare sources, there is a misallocation of resources equal to more than 2 percent of GNP. Supposing instead a bias of 10 percent would imply misallocation of over one-quarter of national income.

We must emphasize again that these calculations are only meant to suggest the range of costs which may occur. Moreover, they do not include effects on the rate of savings, on the tendency to view material welfare in relative terms, on the distribution of income, or on inhibiting the provision of public goods through the government. Nor do they include the costs of wasteful physical product differentiation, or of non-monetary costs resulting from tooth decay in children caused by soft drinks and candy, cancer in adults from the use of tobacco, obesity through perversion of diet, and other diseases and health hazards.

D. Topics for Further Research

Expanding the scope of consumer education along the lines indicated in this study will require research. We envision that an appropriate agenda for the Office of Consumers' Education would address the development of curriculum, identification of content of educational programs, and additional study of the kinds of informational needs required to give programs direction.

One major focus of curriculum development should be an explication of the range of economic problems besetting the supply of both private and public goods and services. An educational program which clearly and simply documents the need for change in many of the economic institutions, particularly at the interface of government and the private sector, could be structured on a very factual basis. Thought should also be given to the most effective means for disseminating this information. Also along these lines, OCE should consider publishing or otherwise making available more detailed information on the policy alternatives and economics of certain specific issues, such as, energy pricing or import/export policies. The average citizen has no readily accessible source of information which will enable him or her to read the newspaper intelligently on a great number of issues. In fact, the same may be said of the average reporter.

The objective of the research just described is to highlight the need for and potential benefits of increased citizen advocacy of their own economic interest. Providing information on how citizens could become more involved in the issues affecting them is an additional topic for research. It is not particularly difficult to compile a list of citizen groups. How to present and disseminate information effectively that will involve the public should be the major concern.

A final major area of curriculum development addresses the issues of biases in preference formation induced by advertising. A clear explication of the nature of the tradeoffs between work, leisure, consumption of market vs. non-market goods, and spending, borrowing and saving, would certainly be a socially benign education initiative and may well be very beneficial. It would not be necessary to engage in a controversial criticism of advertising methods and practices, though some factual evidence could be cited substantiating the notion that advertising may be far more persuasive in determining our styles of consumption and spending than is commonly realized.

Advertising and the nature of information provided by the public and private sectors is also a legitimate topic of study to aid OCE in formulating its goals. Further research on the questions of information content and forms of bias in advertising seem warranted, so that consumers could be informed about them. The peculiar nature of the advertising market, wherein elements of

entertainment and information are blended, could be an ancillary subject of research. Though that topic does not fall within the immediate concern of OCE, it does help in understanding the infirmities of private advertising from the social point of view.

Clearly this is a rich menu of research, ranging from more practical questions of implementation and dissemination to further defining the goals and potential benefits of consumer education. We believe the most weight should be attached to creating good educational programs on the economic problems of the supply side in both the private and public sectors. A necessary adjunct to those programs is a program addressing avenues for public involvement.

FOOTNOTES

Chapter 1

None

Chapter 2

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